8

No. 90-659-CFX
Status: GRANTED

Title: Keith R. Gollust, et al., Petitioners
v.
Ira L. Mendell, etc., et al.

Docketed:
October 23, 1990

Court: United States Court of Appeals
for the Second Circuit

Counsel for petitioner: Mishkin,Edwin B.

Counsel for respondent: Malchman,Irving, Kleinberg,Norman C.

Entry	Date	Note	Proceedings and Orders
1	Oct 23 1990	G	Petition for writ of certiorari filed.
2	Nov 26 1990		Brief of respondents Ira L. Mendell, etc., et al. in opposition filed.
3	Nov 28 1990		DISTRIBUTED. January 4, 1991
4	Jan 7 1991		Petition GRANTED.
			**
5	Feb 13 1991		Brief of petitioners Keith R. Gollust, et al. filed.
6	Feb 15 1991		Joint appendix filed.
7	Feb 27 1991		SET FOR ARGUMENT MONDAY, APRIL 15, 1991. (3RD CASE)
8	Feb 27 1991	G	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
9	Mar 13 1991		Record filed.
		*	Certified copy of C. A. Proceedings received.
11	Mar 15 1991		Brief of respondents Ira L. Mendell, etc., et al. filed.
12	Mar 15 1991		Brief amicus curiae of SEC filed.
10	Mar 18 1991		Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
13	Mar 22 1991		CIRCULATED.
14	Mar 22 1991		Record filed.
		*	Certified copy of original record (Box)
15	Apr 5 1991	X	Reply brief of petitioners Keith R. Gollust, et al. filed.
16	Apr 15 1991		ARGUED.

1pp

90-659 (1)

No. 90-______

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Edwin B. Mishkin
(Counsel of Record)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners

91

QUESTION PRESENTED

Whether the court below erred in ruling that the phrase in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), granting standing to bring an action thereunder to "the owner of any security of the issuer" can be interpreted to include a "former owner" of such securities, and thereby holding that Respondent could maintain an action under Section 16(b) on behalf of an issuer of securities after he had ceased to own any of its securities?

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.* In addition to these parties, the Securities and Exchange Commission participated in the proceedings before the United States Court of Appeals for the Second Circuit below as *amicus curiae.*

* The following information is provided pursuant to Rule 29.1 of this Court: Petitioner Gollust & Tierney, Inc. is owned by Keith R. Gollust and Paul E. Tierney, Jr., and has no subsidiaries; Petitioner Helston Investment Inc. is wholly owned by Coniston North Atlantic International Corp. and has no subsidiaries.

TABLE OF CONTENTS

TABLE OF APPENDICES

TABLE OF AUTHORITIES

Cases PAGE

PAGE

Statutes

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-______

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates and Helston Investment Inc. ("Petitioners") respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this proceeding on July 25, 1990.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (1a[1]) is reported at 909 F.2d 724 (2d Cir. 1990). The Opinion and Order of the District Court for the Southern District of New York granting summary judgment in favor of Petitioners (30a) is reported unofficially at [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086 (S.D.N.Y. Nov. 8, 1988). The Final Judgment of the District Court (34a) is unreported. The Opinion and Order of the District Court denying Respondent's motion pursuant to Fed. R. Civ. P. 60(b) for relief from the final judgment (35a) is reported unofficially at [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. May 23, 1989).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 25, 1990. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves Section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78p(b), which provides:

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

1 References to the Appendix hereto are cited "_____a".

15 U.S.C. § 78p(b). The phrase "such beneficial owner, director, or officer" in Section 16(b) refers to Section 16(a) of the Exchange Act, 15 U.S.C. § 78p(a), which imposes certain reporting obligations on "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to [Section 12 of the Exchange Act, 15 U.S.C. § 78*l*], or who is a director or an officer of the issuer of such security . . . ."

STATEMENT OF THE CASE

Ira L. Mendell, in behalf of Viacom Inc. and, alternatively, Viacom International Inc. ("Respondent"), filed his original complaint herein in January 1987, alleging that he was then a holder of common stock of Viacom International Inc. ("International"), a company whose shares were listed on the New York Stock Exchange and registered under Section 12 of the Exchange Act, 15 U.S.C. § 78*l*, and that he

was entitled to assert a Section 16(b) claim on behalf of International against Petitioners arising out of their purchases and sales of International stock in 1986.

In June 1987, International was acquired by Arsenal Holdings, Inc. (now named Viacom Inc. and referred to herein as "Viacom") through a merger with a subsidiary of Viacom pursuant to which International became a wholly owned subsidiary of Viacom and the shareholders of International received a combination of cash and Viacom securities in exchange for their shares of International. As a consequence, Respondent ceased to be a shareholder of International, becoming instead a security holder of its new parent corporation, Viacom.

Respondent's amended complaint, served in February 1988 (the "Complaint"), alleged that as a result of the merger, Respondent was now a holder of stock of Viacom. Complaint ¶ 9; 40a. The Complaint also alleged that by reason of the merger, Viacom became "the issuer within the meaning of Section 16(b)." *Id.* at ¶ 20; 43a. Finally, realizing that he may be held to lack standing, Respondent alleged alternatively that his action was brought as a "double-derivative" lawsuit on behalf of International. *Id.* at ¶ 24; 44a.

Petitioners moved for summary judgment in May 1988, arguing that Respondent did not have standing to sue because he was no longer a holder of securities of International—the issuer on whose behalf the suit was brought—and that Respondent could not escape his lack of standing by asserting a "double-derivative" action.

A. The District Court's Standing Decision

On November 8, 1988, the District Court, relying principally on the Second Circuit's decision in *Untermeyer v. Valhi, Inc.*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 488 U.S. 868 (1988), issued an Opinion and Order holding that "[b]ecause, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defendants, their motion [for summary judgment] is granted." *Mendell v.*

Gollust, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086, at 91,086 (S.D.N.Y. Nov. 8, 1988); 31a.

As an initial matter, the District Court noted that Section 16(b) actions may be prosecuted "only by the issuer itself or the holders of its securities," *id.* at 91,086; 32a, and because Respondent no longer owned any International securities, he had no standing to maintain a Section 16(b) action on behalf of International, *id.* at 91,087; 33a.

The District Court then turned to whether Respondent had standing to sue as a security holder of the new parent corporation of the issuer. Noting that International remained a viable corporate entity, and that it had a shareholder—Viacom—the District Court held that the explicit language of Section 16(b) limited the right to sue to either International or Viacom. *Id.* at 91,087; 33a. Respondent, being neither, therefore lacked standing to maintain his action under Section 16(b). *Id.*[2]

---

2 The District Court also rejected Respondent's attempt to circumvent the express standing requirements of Section 16(b) by labelling the lawsuit a "double-derivative" action, stating that "shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b)." *Id.* at 91,087; 33a.

After filing his first notice of appeal from the District Court's November 8, 1988 Opinion and Order, but before any action was taken on Respondent's appeal, in January 1989, Respondent decided on a new tactic: to regain standing to sue, he went into the market and purchased a $1000 bond of International that was part of an issue that had been offered to the public prior to the District Court's November 8, 1988 Opinion and Order. Respondent advised the Second Circuit of his new "status" as a security holder of International and of his intention to make a motion to vacate the District Court's judgment, and the parties thereafter stipulated to withdraw Respondent's appeal from active consideration by the Second Circuit in order to allow Respondent to make his motion pursuant to Fed. R. Civ. P. 60(b).

On May 23, 1989, the District Court denied Respondent's Rule 60(b) motion stating that his "after-the-fact stratagem devised following an adverse opinion" was not a sufficient basis, under Rule 60(b)(6), to vacate the District Court's prior order and judgment. *Mendell v.*

B. The Court of Appeals' Decision

After oral argument was held before the Court of Appeals on November 21, 1989, that court on November 28, 1989 requested the Securities and Exchange Commission (the "Commission") to submit an *amicus curiae* brief setting forth its views on Respondent's standing under Section 16(b). *Mendell v. Gollust*, 909 F.2d 724, 726 (2d Cir. 1990); 6a. The Commission responded by submitting a brief in which it acknowledged that decisions of the other Courts of Appeals (as well as previous cases from the Second Circuit itself) had uniformly denied standing to plaintiffs in situations similar to that of the Respondent here, but nevertheless argued in favor of Respondent's standing principally in order to vindicate what it viewed as the "broad remedial purpose" of Section 16(b).

On July 25, 1990, the Court of Appeals panel, by a 2-1 decision, reversed the District Court's November 9, 1988 ruling granting Petitioners summary judgment based on Respondent's lack of standing.[3]

The opinion of the majority made clear that the focal point of its decision was not the actual language of the standing provisions of Section 16(b) at issue here, but what it perceived to be the broad remedial purposes underlying Section 16(b). The opinion began by discussing the legislative history

---

Gollust, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,051 (S.D.N.Y. May 23, 1989); 38a. Further, in response to Respondent's plea that he did not think of purchasing the International bond sooner, the District Court stated that "[c]ounsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1)." *Id.* at 93,050; 37a. Respondent thereupon filed a second notice of appeal challenging the District Court's denial of his Rule 60(b) motion.

3 The Court of Appeals did not reach the question of the District Court's rejection of Respondent's standing argument based upon an alleged "double derivative" action, 909 F.2d at 731; 18a, but affirmed the District Court's denial of Respondent's Rule 60(b) motion (*see* note 2 *supra*), *id.* at 731-32; 18a-19a. Neither of these issues are raised or addressed in this Petition.

of Section 16(b) and the purposes of the statute, 909 F.2d at 726-27; 7a-8a, and reviewed prior case law involving the construction of Section 16(b) purportedly indicating that where Section 16(b)'s terms are susceptible of differing constructions, it should be construed broadly. *Id.* at 727-28; 8a-10a.

Turning to the standing requirements of Section 16(b), the majority stated that "the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim." *Id.* at 729; 12a. Although the majority acknowledged that "the amount or value of a [Section 16(b)] plaintiff's holdings or his motives for bringing suit are not relevant" to the question of standing, *id.* at 729; 12a, it also reasoned that, in cases such as this, standing could be determined on the basis of an assessment of the likelihood that the statute would be enforced by the available plaintiffs, *id.* at 729; 13a (in cases where original issuer survives merger as wholly owned subsidiary of a new parent corporation, "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders.").

Only after concluding that, as a matter of policy, plaintiffs such as the Respondent here should be granted standing in Section 16(b) cases did the majority actually address the contention that the statutory language did not support this conclusion. *Id.* at 730-31; 15a-16a. In what amounted to nothing more than judicial redrafting of legislation, the majority stated that, because the reference to the "owner of any security of the issuer" in Section 16(b) was not modified by the word "current", the statute did not specifically bar the maintenance of Section 16(b) suits by "former" owners of the issuer's securities. *Id.* at 730; 15a. The majority also attempted to distinguish earlier decisions from the Second, Seventh and Ninth Circuits that had uniformly held that a Section 16(b) plaintiff must remain a security holder of the issuer throughout the litigation, and that if a security holder of the issuer ceases to own such securities, he loses his standing to continue the action. *Id.* at 730-31; 15a-17a. Although its decision is plainly inconsistent with those earlier decisions,

the majority sought to distinguish them on the ground that this case presents a "novel situation" in that Respondent's shares of the issuer corporation were exchanged for securities of its new parent corporation and therefore the issuer's former shareholders had a "continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730-31; 16a-17a.

Finally, although nothing in the record below suggested that the acquisition of International by Viacom (a previously unrelated third party) was in any way related to this lawsuit, the majority stated that its decision had the laudable effect of precluding corporate reorganizations that were effected for the express purpose of avoiding Section 16(b) liability. *Id.* at 731; 17a.

In a thorough dissenting opinion, Senior District Judge Milton Pollack (sitting by designation) noted that "[t]he majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute." *Id.* at 732; 20a. The dissent noted that Respondent "no longer satisfies the plain statutory requirement—ownership of securities of the issuer", *id.* at 732; 21a, and that the decision of the District Court was consistent with prior case law of the Second Circuit and with rulings from the Seventh and Ninth Circuits—the only other circuits to address the issue—as well as with "traditional rulings in other contexts" holding that continuing ownership of securities of the issuer is required in order to present a justiciable case or controversy. *Id.* at 733; 22a-23a.

The dissent also noted that the Commission itself recognizes "that qualifying former shareholders to sue, either judicially or by rule-making, is a marked departure from the pre-existing jurisprudence under § 16(b)." *Id.* at 735; 26a-27a. The dissent observed that "Congress simply has not delegated to the courts the authority to qualify a 'former' owner as an 'owner of any security of the issuer' ", *id.* at 735; 27a, and "[t]here is simply no indication in any of the legislative

history of § 16(b) that the plain meaning of the words 'owner of any security of the issuer' was meant to include or even could include one who is no longer the owner of any security of the issuer," *id.* at 735; 28a. Accordingly, the dissent urged the court to "reject [Respondent's] invitation to draft 'judicial legislation' to grant him standing." *Id.* at 736; 29a (citation omitted).

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE COURT OF APPEALS RAISES SIGNIFICANT QUESTIONS CONCERNING THE CRITICAL THRESHOLD ISSUE OF STANDING UNDER SECTION 16(b) OF THE EXCHANGE ACT THAT HAVE NOT PREVIOUSLY BEEN ADDRESSED BY THIS COURT

The specific issue before the Court of Appeals was whether, under Section 16(b), an owner of a security of the issuer has standing to continue a Section 16(b) action once he no longer owns any security of the issuer. The broader issue presented in this case is whether the federal courts have the power to expand upon the unambiguous language of Section 16(b) to accord standing to sue to one who does not meet the statutory requirement in order to further what those courts perceive to be the remedial purposes of the statute. The Court of Appeals majority below, in an unprecedented opinion, answered both questions in the affirmative.

This Court has not addressed any question of interpretation of Section 16(b) in fourteen years, since *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976), and has never addressed the important threshold question of the circumstances, if any, under which a plaintiff who does not constitute "the issuer, or . . . the owner of any security of the issuer" has standing to commence and maintain an action under Section 16(b). In other Section 16(b) cases, however, this Court has consistently required that, in interpreting the carefully circumscribed provisions of this unique strict

liability statute, courts limit liability to situations that are plainly and unambiguously covered by the language of the statute. In finding that, under the circumstances of this case, Respondent has standing to maintain this action, the Court of Appeals below exalted judicially determined "policy" over the plain language of the statute in clear disregard of this Court's well-established Section 16(b) jurisprudence.

A. The Court Of Appeals Improperly Ignored The Plain Language Of Section 16(b)'s Standing Provisions

The opinion below makes clear the virtual exclusive reliance by the majority on its perception of the "policy behind the statute" in interpreting the language "owner of any security of the issuer" to include a person who is no longer such an owner. 909 F.2d at 729; 12a ("In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim."). Although the majority noted the principle that "only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose," *id.* at 728; 9a (citation omitted), it failed entirely to establish what it claimed to be the predicate for its heavy reliance on the policy behind the statute.

The majority's assertion that it was free to consider the policy behind the statute because the relevant language of Section 16(b) allowed alternative constructions, *id.* at 728; 10a (citing *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 424 (1972); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 (1973)), is insupportable. The language of Section 16(b) gives no indication whatsoever that a "former" owner of a security of the issuer may maintain an action. Besides issuers themselves, Congress chose to provide Section 16(b) standing only to those who are "the owner[s] of any security of the issuer"—a provision that cannot reasonably be read to include "a person who is not now an owner but once was the owner of any security of the issuer."

The majority turned the straightforward statutory language on its head by asserting that, since Congress did not insert the word "current" before the word "owner" in the statute, "former" owners may sue if the court determines that permitting such a suit would advance the remedial purpose of the statute. 909 F.2d at 730; 15a. It must be presumed, however, that when Congress imposes as a condition to standing to bring a lawsuit the requirement that the plaintiff have a specified status, it intends to require that the plaintiff have that status currently, rather than in the past. The use of the qualifier "current" would add nothing.[4]

Contrary to the reasoning of the court below, if Congress had for any reason intended to broaden the standing requirements of Section 16(b) to include former owners, it could easily have done so. *Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam). But Congress authorized only "owners"—not "owners or former owners"—to bring suit under Section 16(b). Nor is there anything in the legislative history remotely indicating that Congress intended such an illogical reading of the word "owner." *See id.* at 804 ("We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading."); dissenting opinion below, 909 F.2d at 735-36; 28a. As this Court has admonished, "congressional silence . . . cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 n.13 (1985).

Under the plain meaning of Section 16(b), only an existing owner of a security of the issuer has standing to commence and maintain such an action. Whatever the merits or demerits

4 Indeed, the majority's argument in support of its construction of the statute would support such absurd results as permitting diversity jurisdiction to exist in a suit between residents of the same state, so long as one of the parties formerly resided in a different state, simply because 28 U.S.C. § 1332(a)(1) is not limited to "current" citizens of different states.

of the statute's failure to extend standing to "former" owners of such a security, this limitation "is inherent in the statute as written, and its correction must lie with Congress," not with the courts. *Id.* at 499. As this Court noted in *Blau v. Lehman*, 368 U.S. 403, 413 (1962), in which the Court rejected a prior invitation by the Commission to judicially rewrite Section 16(b)'s scope, "Congress is the proper agency to change an interpretation of the [Exchange] Act unbroken since its passage, if the change is to be made." *See also TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute."); *Lewis, supra*, 762 F.2d at 804 ("We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement.") (citing *Badaracco v. Commissioner*, 464 U.S. 386 (1984)); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("[T]he statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). As the dissent below concluded:

> The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.

909 F.2d at 735-36; 28a-29a (footnote omitted).

B. The Court Of Appeals' Reliance On Perceived Policy In Expanding Upon The Language Of Section 16(b) Contradicts This Court's Long-Established Section 16(b) Jurisprudence

Section 16(b) is unique among the express civil liability provisions of the Securities Act of 1933 (the "Securities Act") and the Exchange Act. While every other express civil liability provision in the Securities Act or Exchange Act "contains a state-of-mind condition requiring something more than negligence," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976), Section 16(b) is, by its terms, a strict liability statute, imposing liability "irrespective of any intention on the part of [the] beneficial owner, director, or officer," Section 16(b), 15 U.S.C. § 78p(b). Moreover Section 16(b) is the only express civil liability provision in the Securities Act or Exchange Act that does not expressly limit standing to persons who purchase or sell securities in connection with the alleged violation.[5] *Cf. Blue Chip Stamps v.*

5 *See* Section 11 of the Securities Act, 15 U.S.C. § 77k (liability for material misstatements or omissions in a registration statement; right of action provided for "any person acquiring [a] security"); Section 12 of the Securities Act, 15 U.S.C. § 77*l* (liability for offers or sales of securities in violation of prospectus delivery requirements or by means of prospectus or oral communications that include material misstatements or omissions; right of action for "the person purchasing such security from" the defendant); Section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e) (liability for certain fraudulent and manipulative practices; right of action for "any person who shall purchase or sell any security at a price which was affected by such act or transaction"); Section 18 of the Exchange Act, 15 U.S.C. § 78r (liability for false or misleading statements contained in certain documents filed with the Commission; right of action for "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement"); Section 20A of the Exchange Act, 15 U.S.C. § 78t-1

Manor Drug Stores, 421 U.S. 723, 734 (1975) (citing Section 16(b) in support of the proposition that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly.").[6]

Partly in recognition of the broad sweep of Section 16(b), this Court has consistently required that its provisions be interpreted narrowly. Indeed, in every decision by this Court interpreting Section 16(b), this Court has rejected any proposed expansive interpretation of the statute.[7] In *Foremost-*

(liability for insider trading; right of action to "any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class"). In addition, Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), provides a right of action to declare certain contracts made in violation of the Exchange Act void. Although the statute does not set forth an express standing requirement for all actions brought under it, it does provide an express limitations period for certain actions brought "by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security."

6 Section 16(b) also has a longer limitations period than the other express civil liability provisions of the Securities Act and Exchange Act. Section 16(b) claims may be brought up to two years "after the date [the] profit was realized." All other express civil actions under the Securities Act and Exchange Act must be brought within one year of the date of the violation or the date of discovery of the violation.

7 *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (defendant must be 10% beneficial owner before purchase of securities is subject to § 16(b); not sufficient that purchase of securities causes defendant to become 10% beneficial owner); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (binding option for defeated tender offeror to sell post-merger securities not deemed a "sale" under § 16(b) because potential for abuse not present); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972) (§ 16(b) applies only to sales occurring while defendant is 10% beneficial owner; sales occurring after defendant had reduced ownership to 9.96% outside scope of statute); *Blau v. Lehman*, 368 U.S. 403 (1962) (partnership of which director in issuer corporation was a partner could not be held liable under § 16(b) for profits earned by it in short-swing transactions).

McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232, 251 (1976), this Court noted that Section 16(b) "imposes liability without fault within its narrowly drawn limits." The Court went on to say that "[i]t is inappropriate to reach the harsh result of imposing § 16(b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference." *Id.* at 252; *see also Reliance Elec., supra*, 404 U.S. at 427 ("[W]e are not free to adopt a construction that not only strains, but flatly contradicts, the words of the statute."). As this Court has previously emphasized, because Section 16(b) imposes a standard of strict liability, it is generally applied with a "mechanical quality." *Reliance Elec., supra*, 404 U.S. at 425.

In ignoring the plain, unambiguous language of the statute, the majority below not only disregarded, but flatly contradicted, the clear mandate of this Court not to construe Section 16(b) expansively even when the language is unclear. Indeed, the majority's statement that "[w]hen the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes," 909 F.2d at 728; 10a, stands on its head this Court's statement in *Foremost-McKesson* that ambiguities are to be resolved against liability.

Moreover, in the two decisions of this Court cited by the majority below as authority for its heavy reliance on the perceived policy underlying the statute, *Kern County Land Co., supra*, and *Reliance Elec., supra*, *see* 909 F.2d at 727-28; 8a-10a, as well as in every other decision of this Court addressing Section 16(b) (*see* note 7 *supra*), this Court actually declined to apply an expansive reading of Section 16(b). As this Court noted in *Foremost-McKesson, supra*, 423 U.S. at 252, "[i]n neither [*Kern County Land Co.* nor *Reliance Elec.*] did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16(b)."

The weakness of the majority's analysis in relying on perceived policy over the plain language of the statute is highlighted by the inconsistency with which it applies that analysis. In an effort to avoid the effect of prior decisions of other circuits, and of the Second Circuit itself, holding that shareholders who were completely "cashed out" in a merger involving the issuer did not have standing under Section 16(b), *see Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767-68 (7th Cir. 1979); *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the majority limited its expansion of the standing requirement to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer." 909 F.2d at 730-31; 16a-17a. This arbitrary, piecemeal expansion of the statute to provide standing to some, but not all, former holders of securities of the issuer (only those who now hold securities in the acquiror of the issuer) completely undercuts the majority's interpretation of the language of the statute as not limited to "current" shareholders. If the language of the statute were in fact susceptible of being interpreted as granting standing to those who formerly held securities of the issuer, there is no principled basis for distinguishing between those who were cashed out in a merger and those who received, in exchange for their securities in the issuer, securities of the issuer's acquiror.

The self-contradictory approach of the majority below demonstrates the dangers of embarking on inquiries into perceived policies behind statutes where such inquiries are not justified or compelled by the statutory language—especially where Section 16(b) is concerned. By relying on what it perceived as the sole policy behind Section 16(b) of preventing insider trading, the majority ignored Congress's clear countervailing policy—manifest in the language of the standing provisions of the statute itself—of providing standing for this strict liability statute only to a narrowly, and clearly, defined group of parties. *See Foremost-McKesson*, *supra*, 423 U.S.

at 252 ("It is not irrelevant that Congress itself limited carefully the liability imposed by § 16(b).").

Although this Court has not previously addressed the issue of standing under Section 16(b), the decision of the Court of Appeals below is contrary to this Court's long-established principles of statutory construction in the Section 16(b) context. This Court should review that decision to clarify the applicable law in the important threshold question of standing in Section 16(b) cases.

II. THE DECISION OF THE COURT OF APPEALS DIRECTLY CONFLICTS WITH DECISIONS FROM THE SEVENTH AND NINTH CIRCUIT COURTS OF APPEALS

Despite the efforts of the majority below to avoid a conflict with prior decisions, its ruling that "owner of any security of the issuer" also means "former" owner of any security of the issuer is squarely at odds with rulings of the Seventh and Ninth Circuits—the only other Courts of Appeals that have addressed the issue—as well as with prior case law of the Second Circuit itself. These prior decisions confirmed that the plain meaning of "owner of any security in the issuer"—as set forth in Point I above—confers standing only on one who continues to be an owner of the issuer's securities throughout the lawsuit.

In *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979), a case that is virtually indistinguishable from the instant case, the plaintiff commenced a Section 16(b) action to recover profits from short-swing trading in shares of KBI. At the time the action was commenced, the plaintiff was a shareholder in KBI as well as another corporation (Cabot). Five days after the commencement of the action, KBI entered into a merger transaction in which shareholders of KBI were cashed out and as a result of which KBI became the wholly owned subsidiary of CSMC, which in turn was a subsidiary of Cabot. The plaintiff then amended his com-

plaint to assert that he was maintaining it on behalf of Cabot as well as KBI.

The Seventh Circuit was faced with two questions: Was the plaintiff still an "owner of any security of the issuer" (KBI) within the meaning of Section 16(b)? And did the plaintiff's status as a shareholder of Cabot give him standing under Section 16(b)? The court answered both questions in the negative.

As for the plaintiff's status as an "owner of any security of the issuer," the court ruled that once the plaintiff lost his shares of KBI, he lost his standing to sue on its behalf under Section 16(b). *Portnoy*, 607 F.2d at 767 (citing *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977)).

On the second question, whether owning a security of the grandparent of the issuer was sufficient to confer Section 16(b) standing, the court noted that the policy grounds used to permit such standing did not permit it to "rewrite the statute to accommodate this situation [since] Congress has spoken clearly." 607 F.2d at 768. The court noted that, as is true in this proceeding, the issuer still existed and its sole shareholder (there CSMC, here Viacom) "had the right to bring the action regardless of whether it chose to exercise that right." *Id.* at 769. In a passage that could easily have been directed at the reasoning of the Court of Appeals below, the Seventh Circuit further noted that "[i]t would be a dangerous precedent to confer standing on a plaintiff who falls outside the class of parties permitted by the language of the statute to bring suit merely because the only parties that fall within the class choose not to exercise their right to sue."[8] *Id.* Accordingly, the court ruled that the plaintiff lacked standing.

8 The court also noted that, although the result in *Portnoy* may appear to be "a harsh one in that a possible violation will apparently go uncorrected, we note on the more positive side that the plaintiff has not argued that the merger which cut off his standing . . . was accomplished for the fraudulent purpose of avoiding enforcement of the § 16(b) claim." *Id.* Similarly, Respondent has never contended in this case that the acquisition of International by Viacom was undertaken for the purpose of avoiding enforcement of Section 16(b). *See* dissenting opinion below, 909 F.2d at 732; 20a (noting that International was acquired by Viacom "in a merger transaction which had a business purpose").

The Ninth Circuit, in a decision by a panel that included Justice (then Judge) Kennedy, reached a similar result in *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam). There, Coldwell Banker was acquired by Sears through a wholly owned subsidiary of Sears, SDC. Thereafter Coldwell Banker ceased to exist as a separate corporate entity. The plaintiff who commenced this Section 16(b) action was a shareholder of Sears, and had never owned stock of Coldwell Banker or SDC. He sought the recovery of short-swing profits made by a director of Coldwell Banker through the director's sale of his Coldwell Banker shares.

In determining whether the plaintiff had standing, the *Lewis* court concluded that the answer was readily ascertained from the language of the statute:

> Section 16(b) permits a security holder of the issuer to bring a section 16(b) action only after the issuer has failed either to institute an action or to prosecute diligently after instituting an action. We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute. We will not confer standing on a plaintiff who falls outside the class of persons permitted by the language of the statute to bring suit merely because the only parties falling within the class choose not to exercise their right to sue. *Portnoy*, 607 F.2d at 769.

Congress is well aware of the corporate practice of parent companies utilizing wholly owned subsidiaries in merger transactions. Had Congress wanted to discourage this practice by conferring standing on shareholders of a parent corporation whose wholly owned subsidiary absorbed the original issuing corporation, it knew how to do so.

762 F.2d at 804. Accordingly, the *Lewis* court concluded that the plaintiff lacked standing. *See also Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation.") (citing *Portnoy, supra*, and *Rothenberg, supra*), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982).

Prior to the holding of the Court of Appeals below, it had also been the law in the Second Circuit that a plaintiff security holder who commenced a Section 16(b) suit on behalf of an issuer had to own and continue to own his securities of the issuer throughout the litigation, and that if such a plaintiff ceased to own such securities—for any reason—he was denied standing to continue the action.[9] For example, in

9 One exception to this rule was the district court decision in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966). In *Blau*, the court held that a shareholder of American Can Company could bring a Section 16(b) suit against a former director of a company which had sold all its assets to a subsidiary of American Can and thereafter ceased to exist. In sustaining the plaintiff's standing in *Blau*, the court noted that the original issuer had ceased to exist as a corporate entity after the transaction and thus it no longer had any shareholders who could sue. It concluded that to limit standing to the former shareholders of the now defunct issuer would mean that no one could possibly bring a Section 16(b) suit against the company's former directors. In so holding, the court, like the majority below, relied almost exclusively on the perceived policy behind the statute, virtually ignoring the language. *Id.* at 887 ("In sum, the essential argument which the defendant advances is one of language. But language alone can never be dispositive of a statute's meaning."). Other courts have criticized *Blau*'s reasoning. *See, e.g., Portnoy*, 607 F.2d at 769 n.8; *Lewis*, 762 F.2d at 803-04; dissenting opinion below, 909 F.2d at 734; 24a-26a. *Blau* is inapplicable to the instant case in any event because the issuer, International, survived the merger and remains a viable corporation as a wholly owned subsidiary of Viacom.

Prior to the decision below, *Blau* had been distinguished in the Second Circuit on the ground that the issuer in that case was no longer a viable corporate entity. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). Although the majority below referred repeatedly to *Blau* with approval, the majority's "rule"—extending standing only to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer", 909 F.2d at 730-31; 16a-17a—is actually inconsistent with *Blau*, where the plaintiff had never owned a security of the issuer.

Rothenberg v. United Brands Co., [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the district court held, and the Second Circuit affirmed, that a shareholder who had commenced a Section 16(b) suit lost his standing to continue that suit when he ceased to be a shareholder of the issuer as a result of a "short form" merger (in which public shareholders, including the plaintiff, had no vote) following a tender offer that the plaintiff had refused to accept.[10]

In *Herrmann v. Steinberg*, 812 F.2d 63 (2d Cir. 1987), the Second Circuit vacated and remanded a decision of the district court that had incorrectly calculated Section 16(b) short-swing profits. In what the Second Circuit described as "a threshold matter," the plaintiffs were admonished that on

10 The majority below "caution[ed] against an overbroad application of *Rothenberg*" in part on the ground that its "standing analysis was premised on an analogous application of Rule 23.1 which . . . does not govern shareholders bringing § 16(b) claims." 909 F.2d at 730; 16a. However, the *Rothenberg* court was well aware of the distinctions between Section 16(b) claims and Rule 23.1, *see Rothenberg* at 91,692, and the majority's opinion below even cited *Rothenberg* in a discussion of the distinctions between Section 16(b) claims and Rule 23.1. 909 F.2d at 728; 11a.

remand they "must establish that they have been [the issuer's] shareholders throughout this litigation." *Id.* at 67 n.4 (citing *Rothenberg, supra*; *Lewis, supra*; and *Portnoy, supra*).

Finally, in *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on rch'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988), the issuer (Sea-Land) was merged with another corporate entity such that Sea-Land survived and became the wholly owned subsidiary of CSX. In dismissing the plaintiff's Section 16(b) action—on the ground that the plaintiff, an owner of CSX stock, lacked standing because he was not the owner of any security in the issuer, Sea Land—the district court identified the only parties that would have standing to pursue such an action: the issuer (Sea-Land) or its sole shareholder (CSX). In affirming the district court's decision, the Second Circuit also identified these parties as the only entities that would be entitled to maintain a Section 16(b) action. Neither court included in the list "former" shareholders of Sea-Land.

The decision of the Court of Appeals below thus plainly stands out in stark contrast to these prior decisions of the Second, Seventh and Ninth Circuits in its willingness to expand the standing provisions of Section 16(b). Indeed, even the Commission, which filed an *amicus* brief in the Court of Appeals below in support of Respondent, has recognized—in releases issued in connection with a pending proposal by the Commission to amend its rules under Section 16(b)—that it was settled law prior to the Court of Appeals' decision in this case that Section 16(b) plaintiffs must hold their securities of the issuer throughout the course of the litigation. *See, e.g.*, Exchange Act Rel. No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620-21.[11]

11 The majority opinion below cited the Commission's views, including the proposed new rules under Section 16(b), in support of its result, although it acknowledged that "the proposed rule is inapplicable in the case at hand." 909 F.2d at 730; 14a (citing *Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990)). As the dissent noted, however, " '[the Commission's] presumed "expertise" in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants.' " 909 F.2d at 734 n.2; 24a (quoting *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977)).

In an effort to characterize its decision as not conflicting with these established precedents from its own and other circuits, the majority below identified certain distinctions that purport to set the instant action apart from decisions discussed above.

The sole distinction the majority found in this proceeding from *Portnoy* and *Rothenberg* is that in those cases, the holders of the issuer's securities received only cash for their securities whereas in the instant action, Respondent received cash *and* some stock in the acquiror. The majority maintained that here, unlike in *Portnoy* and *Rothenberg*, Respondent—by virtue of receiving stock in the acquiror—"continues to have at least an indirect financial interest in the outcome of this lawsuit." 909 F.2d at 730; 16a. As for *Lewis* and *Untermeyer*, the majority noted as the sole distinction the fact that in those actions, the plaintiff never held stock in the issuer, but only in the parent corporation. *Id.* at 730; 15a-16a. These distinctions, however, lack substance.

As an initial matter, the majority did not explain why the statutory analysis followed in these cases is not applicable to this proceeding. As set forth above, the Seventh and Ninth Circuit Courts of Appeals have found the language of Section 16(b) at issue to be plain and unambiguous. As noted in Point I, *supra*, statutory language, if clear and unambiguous, will ordinarily be regarded as conclusive, "since it is generally assumed that Congress expresses its purpose through the ordinary meaning of the words it uses." *Lewis, supra*, 762 F.2d at 804 (citing *Escondido Mut. Water Co. v. La Jolla Band of Missions Indians*, 466 U.S. 765, 772 (1984);

North Dakota v. United States, 460 U.S. 300, 312 (1983); *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Similarly, the Court of Appeals failed to address the rejection in these prior decisions of the same "policy arguments" that appear to be the sole foundation for the result reached below.

More importantly, the distinctions drawn by the majority prove to be meaningless. First, the majority does not appear to disagree with the general rule that one who owns securities *only* in the parent of the issuer does not have standing under Section 16(b). *See* 909 F.2d at 730; 15a-16a (discussing *Untermeyer* and *Lewis*). The majority opinion, however, seeks to create an exception to this rule for a plaintiff whose securities of the issuer were exchanged for securities in the parent corporation in a merger transaction, thus giving the plaintiff "a continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730; 16a-17a.

The majority's purported distinction wholly fails to explain the opposite result that was reached in *Portnoy*. The plaintiff in *Portnoy* owned securities of the grandparent corporation of the issuer at the time of the merger, and therefore had a "continuing financial interest in the litigation" in every sense that Respondent did here. The majority's implied distinction on the ground that Respondent received his shares in the issuer's parent *in exchange for* his shares of the issuer, while in *Portnoy* the plaintiff's ownership of shares in the issuer's grandparent was independent of the merger, is irrelevant both to the statutory language and to the majority's perception of the statutory design.[12]

12 The reasoning of the majority below, tied as it is to the concept of a security holder's continuing financial interest in the outcome of the litigation, is also fundamentally flawed in another respect. The majority reasoned that a shareholder of a parent of the issuer should have standing under this analysis because he may benefit indirectly from any recovery by the issuer. But this reasoning would only make sense, if at all, if the plaintiff owned an *equity* security in the parent (so that a

The majority's judicially crafted exception to the statutory requirement is also at odds with the settled jurisprudence under Section 16(b) with respect to post-transaction purchases of an issuer's securities. As the majority opinion noted:

> The standing requirements for shareholder derivative suits are not applicable to a § 16(b) plaintiff. Generally a derivative plaintiff must be a shareholder at the time of the transaction of which he complains . . . In contrast, in a § 16(b) suit the complaining stockholder need not have held his securities at the time of the objectionable transaction. Suit may be brought by the holder of any of the issuer's securities—equity or debt—regardless of whether the security held is of the same class as those subject to disgorgement as short-swing profits.

909 F.2d at 728-29; 11a-12a (citations omitted).

Under this "well established principle," *Portnoy, supra*, 607 F.2d at 767 n.3, because a Section 16(b) plaintiff does not have to own the issuer's securities at the time of the transaction complained of, it is possible (and often the case) that a plaintiff will actually purchase the issuer's security *after the transaction* for the express purpose of "purchasing" a Section 16(b) action. Accordingly, it is entirely irrelevant under Section 16(b) whether the plaintiff has a continuing financial interest in the issuer from the time of the transaction sued upon.

Applying this analysis to the facts of this proceeding requires that Respondent—who formerly held securities in the issuer but now owns only securities in the new parent—be treated for Section 16(b) purposes in the same manner as an individual who never held securities in the issuer but pur-

financial gain to the parent might increase the value of his shares). In general, a holder of a *debt* security could gain no financial benefit from a recovery by the issuer because his return is fixed. However, for purposes of Section 16(b) standing, it is immaterial whether the security owned by the plaintiff constitutes equity or debt. *See* majority opinion below, 909 F.2d at 728-29; 12a.

chased securities in the parent after the merger. But the majority below would arbitrarily deny standing to the latter and grant it to the former. *See* 909 F.2d at 730; 16a (distinguishing *Lewis*, where plaintiff never held securities in issuer). Even more arbitrary is the distinction the court below seeks to draw between Respondent—who received securities of the acquiror in exchange for his securities of the issuer and is given standing—and the plaintiff in *Portnoy* who, the majority concedes, could not obtain standing because his securities of the issuer were "cashed out" in the merger, even though he independently held securities in the post-merger grandparent corporation of the issuer *at the time of the merger*.

There is no support in the language of the statute, the legislative history or prior case law for distinguishing between a plaintiff who received securities of a parent *directly* in exchange for his securities in the issuer and one who received cash for his securities but already owned securities of the parent (as in *Portnoy*) or one who timely purchased securities of the parent thereafter (as in *Rothenberg*).[13]

Accordingly, there can be no meaningful distinction drawn between this case and the prior decisions of the other Courts of Appeals that have addressed this question, as well as prior decisions of the Second Circuit. Like the plaintiffs in *Portnoy* and *Rothenberg*, when Respondent lost his ownership interest in the issuer, he lost his standing to continue this action. Like the plaintiffs in *Lewis* and *Untermeyer*, the Respondent's ownership of securities of a parent of the issuer does not confer standing under the plain terms of the statute.

Therefore, the majority's holding that a shareholder of the issuer who loses that security and instead acquires a security of the parent corporation nevertheless continues to have standing, is inexorably in conflict with the plain language of

13 In *Rothenberg*, after being cashed out, the plaintiff purchased a security in the ultimate parent of the issuer in an effort to regain standing. The court did not decide whether this revitalized the plaintiff's standing because no demand had been made on the parent entity. *Rothenberg*, at 91,692-93.

Section 16(b) and the decisions of the two other Courts of Appeals that have addressed the issue (as well as with prior precedent in the Second Circuit itself). This Court should review the decision of the Second Circuit below to resolve this clear conflict.

CONCLUSION

For the foregoing reasons, the requested Writ of Certiorari should issue.

Dated: October 22, 1990

Respectfully submitted,

Edwin B. Mishkin
(Counsel of Record)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN
& HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 468, 562—August Term 1989

(Argued November 21, 1989 Decided July 25, 1990)

Docket Nos. 89-7068, 89-7686

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.,

Plaintiffs-Appellant,

—v.—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT, INC., VIACOM INC., and VIACOM INTERNATIONAL, INC.,

Defendants-Appellees.

Before:

OAKES, *Chief Judge*, CARDAMONE, *Circuit Judge*, and POLLACK, *District Judge*.*

* Hon. Milton Pollack, United States District Court for the Southern District of New York, sitting by designation.

Plaintiff, Ira L. Mendell, appeals from an order of the District Court for the Southern District of New York (Mukasey, J.), entered November 9, 1988, granting defendants' motion for summary judgment and dismissing plaintiff's complaint on the grounds that plaintiff lacked standing to bring the claim. Plaintiff also appeals an order, entered May 24, 1989, denying his motion for relief from the November 9, 1988 order and judgment of dismissal pursuant to Federal Rule of Civil Procedure 60(b).

The order of November 9, 1988 is reversed and remanded.

The order of May 24, 1989 is affirmed.

Judge Pollack dissents in a separate opinion.

IRVING MALCHMAN, New York, New York (Kaufman Malchman Kaufmann & Kirby, New York, New York, of counsel), *for Plaintiff-Appellant.*

EDWIN B. MISHKIN, New York, New York (James W. Pharo, Michael S. Sommer, Cleary, Gottlieb, Steen & Hamilton, New York, New York, of counsel), *for Defendants-Appellees other than nominal parties Viacom Inc., and Viacom International, Inc.*

SECURITIES and EXCHANGE COMMISSION, Washington, D.C. (Daniel L. Goelzer, General Counsel, Jacob H. Stillman,

Associate General Counsel, Thomas L. Riesenberg, Assistant General Counsel, Leslie E. Smith, Attorney, and Paul Gonson, Solicitor, Washington, D.C., of counsel), *filed a brief for the Securities and Exchange Commission, Amicus Curiae.*

CARDAMONE, *Circuit Judge*:

This appeal deals with a suit brought to recover short-swing profits against insiders which was dismissed in the district court. It is clear from Supreme Court precedent that liability for short-swing trading will not arise unless the securities transactions at issue fall within the literal language of the statute that prohibits over-reaching by insiders. Here plaintiff's standing to bring suit against insiders, rather than such individuals' liability, is the question presented. In resolving this issue the words of the statute must still be carefully examined, but legislative purpose may also be considered where standing is not clearly precluded by the statutory language. Congressional policy is a stubborn thing; it permeates this area of the law. In resolving this case therefore we must not defeat Congress' plain policy by viewing standing too narrowly.

BACKGROUND

Before us is an order of the Southern District of New York (Mukasey, J.), entered November 9, 1988 that granted summary judgment to defendants dismissing plaintiff's complaint for lack of standing. Plaintiff also

appeals from an order dated May 23, 1989 denying his Rule 60(b) motion for relief from the November 9, 1988 order. Plaintiff appeals that dismissal of his action brought pursuant to § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1988). Section 16(b) provides that an owner of an issuer's security may bring an action in behalf of the issuer to recover short-swing profits realized by the corporation's officers, directors and principal stockholders. A "short-swing" profit occurs when a profit is realized on a purchase and sale, or sale and purchase, of stock occurring within a period of six months. The statute requires officers, directors and owners of more than ten percent of the issuer's stock (insiders) to disgorge short-swing profits back to the issuer.

The question presented is whether a shareholder whose shares in an issuer are converted by a business restructuring into shares of a newly formed parent corporation that owns all of the stock of the issuer loses standing to maintain a previously instituted § 16(b) suit. Because we think the answer to the question posed is "no," the grant of summary judgment dismissing plaintiff's suit must be reversed.

FACTS

Plaintiff Ira L. Mendell is a former shareholder of Viacom International Inc. (International). Defendants are limited partnerships, general partnerships, individual partners and certain corporations (Coniston or the Coniston defendants) that together invested in the stock of International. In 1986 defendants collectively owned more than ten percent of its stock. In January 1987 plaintiff filed a complaint alleging that Coniston was

liable to International pursuant to § 16(b) for profits arising out of Coniston's purchases and sales of International stock in 1986. Plaintiff asserted that on trades of International stock made between July and October 1986 the Coniston defendants acquired approximately 11 million dollars in short-swing profits at a time when they were insiders by virtue of their ownership of more than ten percent of International stock. The complaint also alleged that in October 1986 a demand was made upon International and its Board of Directors to institute a § 16(b) suit against the Coniston defendants, but that though more than 60 days had passed no suit had been commenced by International.

Approximately six months later, in June 1987, after plaintiff had filed suit, International was acquired through a merger transaction by Arsenal Acquiring Corporation, a shell corporation formed for that purpose. All of International's stock was exchanged for a combination of cash and stock in Arsenal Acquiring's parent corporation called Arsenal Holdings, Inc., and Arsenal Acquiring then merged into International, which thereby became a wholly-owned subsidiary of the parent, Arsenal Holdings. As part of the merger, Arsenal Holdings changed its name to Viacom, Inc. (Viacom). Thus plaintiff, who held shares in International when he brought suit to recover insider profits for the issuer, now holds shares in its parent, Viacom. Viacom is the sole shareholder of International, and International is the parent corporation's sole asset.

At a pretrial conference held in February 1988 defendants asserted that plaintiff no longer had standing to maintain his § 16(b) suit since he was no longer a shareholder of International. In March 1988 plaintiff served

an amended complaint asserting that he had standing to bring the action in behalf of Viacom, the parent corporation, which he claimed was effectively the "issuer." Alternatively, he contended that he had standing to bring the action as a double-derivative action in behalf of International. Coniston moved for summary judgment. On November 9, 1988 the district court granted summary judgment to defendants because plaintiff lacked standing, ruling that "[s]uits to disgorge ill-gotten gains under § 16(b) may be prosecuted only by the issuer itself or the holders of its securities." *Mendell v. Gollust*, [1988-89] Fed. Sec. L. Rep. (CCH) ¶ 94,086 at 91,086 (S.D.N.Y. 1988).

On January 9, 1989—after the opinion issued but before the judgment of dismissal was entered on January 17, 1989—plaintiff purchased a subordinated note issued by International. In March 1989 plaintiff made a motion pursuant to Fed. R. Civ. P. 60(b) asserting that he now had standing as a noteholder of International, and that the judgment entered some weeks earlier should be vacated. In an opinion dated May 23, 1989 the district court denied the Rule 60(b) motion stating that counsel's failure to advise his client to purchase the note earlier did not provide grounds to overturn the judgment. *See Mendell v. Gollust*, [Current Volume] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. 1989).

We heard oral argument on November 21, 1989, and on November 28 requested the Securities and Exchange Commission (SEC) to submit an *amicus curiae* brief setting forth its views on plaintiff's standing under § 16(b). We now have the benefit of the SEC's *amicus curiae* brief filed on January 10, 1990.

DISCUSSION

I Section 16(b)

A. *Policy Considerations and Legislative Purpose*

In order to determine how broadly § 16(b)'s standing requirements should be construed, we begin with a brief examination of the policy considerations and the legislative purpose that preceded the enactment of the statute. The Securities Act of 1934 in general and § 16(b) in particular were passed to insure the integrity of the securities markets and to protect the investing public. *See* 15 U.S.C. § 78p(b) (1988); Federal Securities Exchange Act of 1934, S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934) [*Senate Report*]; 2 L. Loss, *Securities Regulation* 1037-38, 1040-41 (2d ed. 1961).

The Committee on Banking and Currency heard many instances where insiders either personally or through the medium of holding companies made large profits from the use of information not available to the public. *Senate Report* at 9. It concluded that the reporting requirements regarding changes in insider holdings and the provision making profits recoverable on sales or purchases made within six months would render difficult or impossible trading on advance information by insiders for profit. *Id.* The bill's provisions were for the express purpose of preventing the unfair use of inside information. *Id.* at 21.

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came

to them in such positions, to aid them in their market activities.

Stock Exchange Practices, Report of the Committee on Banking and Currency, S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). Hence, Congress envisioned § 16(b) as a remedial law that would deter those "intrusted with the administration of corporate affairs or vested with substantial control over corporations [from using] inside information for their own advantage." *Id.* at 68.

B. *Judicial Construction of § 16(b)*

Since its passage the Supreme Court has construed § 16(b) in a number of cases. In the earliest, *Blau v. Lehman*, 368 U.S. 403 (1962), it refused to hold an entire partnership liable for short-swing profits as an insider when one of its members was a director of the issuer because the plain language of § 16(b) did not provide for partnership liability, though the director was susceptible to suit in his individual capacity for the profits he realized. *Id.* at 411-14. In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), a tender-offeror that purchased more than ten percent of the stock of Kern County Land Co. had its shares of Kern converted into new Tenneco stock when Tenneco merged with Kern in a defensive transaction. The tender-offeror negotiated a contract to sell to Tenneco the shares it would receive after the merger. Writing that traditional cash-for-stock purchases fall within § 16(b), but that certain "unorthodox" transactions are not so easy to resolve, the Court observed that these "borderline" transactions are within the statute's reach if they are a vehicle promoting the evil Congress

sought to prevent. *Id.* at 593-94. The Court noted that the transaction in question was not based on a statutory insider's information and therefore was not vulnerable to the speculative abuse barred by § 16(b), and held that neither the exchange of shares in the merger nor the execution of the option contract constituted a "sale" under § 16(b). *See id.* at 600-01.

In *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972), Emerson Electric, a holder of more than ten percent of Dodge Manufacturing Co., made two sales of stock within six months after purchasing it, the first of which reduced its holdings to less than ten percent. The question was whether the profits from the second sale, made within six months of its purchase but not while Emerson was a ten percent holder, were recoverable by the corporation under § 16(b). In holding that they were not, the Supreme Court observed that a ten percent owner must under the statute be such " 'both at the time of the purchase and sale . . . of the security involved,' " 15 U.S.C. § 78p(b), and since Emerson Electric was not such an owner at the time of the second sale, the method it had used to avoid liability was one permitted by the statute. 404 U.S. at 422-23. The Court reasoned that, because liability under the statute is predicated upon objective proof, a trader's intent and/or motive is irrelevant and hence, Emerson Electric was not liable under § 16(b). *Id.* at 425. In *Reliance* the statutory language was clear; only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose. *Id.* at 424. Here, we are faced with the latter scenario.

C. *Broad Interpretation of § 16(b)*

When the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes. The disgorgement provision is aimed at deterring insider trading by removing the profits from "a class of transactions in which the possibility of abuse [is] believed to be intolerably great." *Id.* at 422. The statute presumes that insiders in a company have access to nonpublic information regarding its operation and will use that information when trading in the issuer's stock, and thus proof of the actual use of such inside information is not required. *See Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 243, 251 (1976); *Reliance Elec.*, 404 U.S. at 422; *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235-36 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

We and most other courts have adopted a "pragmatic" approach, construing § 16(b) in a manner that seems most consistent with Congress' purpose. *See Kern County Land Co.*, 411 U.S. at 594 ("the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent"); *Reliance Elec.*, 404 U.S. at 424 ("where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."); *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 262 (2d Cir. 1969) (courts interpret § 16(b) in ways most consistent with legislative purpose "even departing where necessary from the literal statutory language."), *cert. denied*, 396 U.S. 1036 (1970).

II Standing Under § 16(b)

A. *Broadly Construed*

To effectuate its purposes the statute permits "the owner of any security of the issuer" to bring suit in behalf of the corporation. 15 U.S.C. § 78p(b). Such person may institute a § 16(b) claim in behalf of the issuer if the latter fails to bring suit after the stockholder so requests. *See id.* Because such a suit is not brought in his own, but rather the corporation's behalf, § 16(b)'s standing requirements have been given wide latitude. *See Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953); *see also Prager v. Sylvestri*, 449 F. Supp. 425, 429 (S.D.N.Y. 1978) (demand requirement of § 16(b) exists for benefit of the issuer; defendant insider may not assert lack of demand as a defense.). A § 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. *See Magida v. Continental Can Co.*, 231 F.2d 843, 846-47 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956).

The standing requirements for shareholder derivative suits are not applicable to a § 16(b) plaintiff. *See Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Rothenberg v. United Brands Co.*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691-92 (S.D.N.Y.); *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); 2 L. Loss, *Securities Regulation* at 1045-47. Generally a derivative plaintiff must be a shareholder at the time of the transaction of which he complains, the action must not be a collusive one to confer federal jurisdiction, and the complaint must allege with particularity the efforts made to obtain the desired action. *See* Fed. R. Civ. P. 23.1. In contrast, in a

§ 16(b) suit the complaining stockholder need not have held his securities at the time of the objectionable transaction. *See Blau v. Mission Corp.*, 212 F.2d at 79. Suit may be brought by the holder of any of the issuer's securities—equity or debt—regardless of whether the security held is of the same class as those subject to disgorgement as short-swing profits. *See* 15 U.S.C. § 78p(b); *Smolowe*, 136 F.2d at 241; 2 L. Loss, *Securities Regulation* at 1046. Further, the amount or value of a plaintiff's holdings or his motives for bringing suit are not relevant. *See Magida*, 231 F.2d at 847-48.

In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim. Thus, in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966) (Weinfeld, J.), the district court permitted a shareholder of a *parent corporation* to bring a § 16(b) suit on behalf of its issuer-subsidiary. There the company that issued the stock that was traded in contravention of the statute was dissolved in a merger. The court reasoned that where the issuer is merged out of existence, none of the original shareholders are left to bring suit. *Id.* at 886. A holding that would allow only the shareholders of the now defunct issuer to remedy the statutory violation would therefore make the statute unenforceable. *See id.* at 886-87; *see also Portnoy v. Kawecki Berylco Indus. Inc.*, 607 F.2d 765, 768 (7th Cir. 1979). In order to avoid a result that was contrary to the purpose of the statute the court interpreted the word "issuer" to include the parent corporation. *Oppenheim*, 250 F. Supp. at 884.

Defendants urge that we limit *Oppenheim* to permit a shareholder of a parent corporation to maintain a § 16(b) suit with respect to the subsidiary's stock only when the original issuer did not survive a merger into the subsidiary. They contend that when the issuer survives the merger as a viable corporate entity enforcement of the statute by the issuer or by its shareholder, the parent corporation, is still available. We disagree with defendants' rationale; it would have been equally applicable to *Oppenheim* because there the § 16(b) claim could have been brought by the issuer's survivor or by its shareholder, the parent corporation, yet the court did not restrict standing to those entities. The plaintiff in *Oppenheim* actually had less claim to standing than the plaintiff in the instant case, because in *Oppenheim* the plaintiff never held shares in the original issuer, but purchased shares in the parent only after the merger. Further, we do not rely on the interpretation of "issuer" set forth in *Oppenheim*, but focus instead on whether a security holder loses his standing as an "owner" of securities when his stock is involuntarily converted in a merger.

The probability that the statute will not be enforced is present to the same degree when the original issuer survives the merger as a wholly-owned subsidiary of the parent corporation as it was in *Oppenheim*. In such circumstance no public shareholders remain to bring an action. As a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders. *See Rothenberg*, [1977-78] Fed. Sec. L. Rep. ¶ 96,045 at 91,691; *cf. Lewis v. McAdam*, 762 F.2d 800, 802 (9th Cir. 1985) (per curiam); *Magida*, 231 F.2d at 846. Leaving insiders to police themselves is not only contrary to § 16(b)'s private shareholder enforce-

ment purpose, but also can be expected to secure the same results as those obtained when a fox guards a chicken coop. Concededly, some protection against insider abuse may still be available through a stockholder's derivative suit for breach of fiduciary duty. Yet such a suit is not as effective as a § 16(b) claim because shareholders are subject to the already noted more stringent standing requirements of Rule 23.1, and, in addition, the complaint may be countered with subjective considerations of intent or good faith, such as a business judgment defense. *Cf. Oppenheim*, 250 F. Supp. at 887.

Moreover, the SEC endorses the view that the policy of § 16(b) is best effectuated by allowing plaintiff to maintain this suit. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Securities Exchange Act Rel. No. 26333 (Dec. 2, 1988), 42 SEC Docket 570, 53 Fed. Reg. 49997 (Dec. 13, 1988) [SEC Rel. No. 26333]. Although not binding on us, the SEC's insights in construing securities laws are entitled to consideration. *See Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 n.10 (1976).

Proposed SEC Rule 16a-1(h) would specifically define "owner" of a security as either a current beneficial owner of securities of the issuer at the time suit was filed *or* a former beneficial owner who was compelled to relinquish his holdings as a result of a business combination. *See* SEC Rel. No. 26333. While the proposed rule is inapplicable in the case at hand, *cf. Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990), it reflects the strength of the SEC's convictions.

B. *Standing Not Barred by Existing Law*

Defendants and the dissenting opinion assert it is "settled law" that a security holder who commences a § 16(b) suit must remain a security holder throughout the litigation and if he ceases to own the securities he loses his standing to continue the action. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on rehearing*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 109 S. Ct. 175 (1988); *Rothenberg*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045; *see also Lewis*, 762 F.2d 800; *Portnoy*, 607 F.2d 765; *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982). That conclusion is not mandated either by the statutory language or by the cited cases.

First, the language of the statute speaks of the "owner" of securities; but such language is not modified by the word "current" or any like limiting expression. The statute does not specifically bar the maintenance of § 16(b) suits by former shareholders and Congress, had it so desired, could readily have eliminated such individuals as plaintiffs. The broad meaning of the word owner better accords with the remedial purpose of the statute. Second, although some decisions have denied standing to a § 16(b) plaintiff on the grounds that he is not a current security holder, those cases are distinguishable. The district court, for example, relied upon *Untermeyer v. Valhi, Inc.*, which dealt with a plaintiff who owned stock of the parent corporation, but who never owned stock of the company that issued the shares traded in contravention of § 16(b). 665 F. Supp at 298. Thus, even without a merger the *Untermeyer* plaintiff would not have had standing. In con-

trast, plaintiff here brought a valid § 16(b) suit while he was a current shareholder of the issuer, and *but for* the merger standing would not be in issue here.

In *Rothenberg v. United Brands Co.*, also cited by the district court, the shareholders received cash in the merger instead of securities. The crucial factor considered by the trial court was that in a cashout merger the former shareholders maintain no continuing financial interest in the litigation. *See Rothenberg*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,692. In the present case all former International shareholders obtained, as a result of the merger, shares of International's parent corporation, and plaintiff, as one of them, continues to have at least an indirect financial interest in the outcome of this lawsuit. Two additional reasons caution against an overbroad application of *Rothenberg*: That decision noted that even if plaintiff had standing the § 16(b) claim failed on the merits, *see id.* at 91,693-94; and the court's standing analysis was premised on an analogous application of Rule 23.1 which, as noted above, does not govern shareholders bringing § 16(b) claims. *Id.* at 91,691-92.

Contrary decisions of our sister circuits are similarly distinguishable. *See Lewis*, 762 F.2d at 801 (plaintiff shareholder of parent but never held stock in the issuer or its surviving subsidiary); *Portnoy*, 607 F.2d at 767-68 (cashout merger left plaintiff with no continuing financial interest in the litigation; plaintiff's alternative status as a shareholder in the grandparent corporation gave no standing for § 16(b) suit on behalf of the issuer). In the case at bar, the conversion of International stock into Viacom stock presents a novel situation where former shareholders have a continuing interest in maintaining

suit in behalf of the issuer. We conclude, therefore, that under those unique circumstances the cases cited by defendants are neither controlling nor persuasive.

Here plaintiff's suit was timely, and while his § 16(b) suit was pending he was involuntarily divested of his share ownership in the issuer through a merger. But for that merger plaintiff's suit could not have been challenged on standing grounds. Although we decline—in keeping with § 16(b)'s objective analysis regarding defendants' intent—to inquire whether the merger was orchestrated for the express purpose of divesting plaintiff of standing, we cannot help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's § 16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present.

Quite plainly, a rule that allows insiders to avoid § 16(b) liability by divesting public shareholders of their cause of action through a business reorganization would undercut the function Congress planned to have shareholders play in policing such actions. *See Oppenheim*, 250 F. Supp. at 887; SEC Rel. No. 26333.

Permitting plaintiff to maintain this § 16(b) suit is not barred by the language of the statute or by existing case law, and it is fully consistent with the statutory objectives. The grant of summary judgment must therefore be reversed. If it is established that profits were realized in contravention of the statute they should be disgorged to International. The section is designed to protect fairness interests, not provide compensatory relief. The result we reach will adequately protect the former International shareholders who now own International indirectly as

shareholders of Viacom. *Cf. American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1060-61 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975).

Because the plaintiff has standing under § 16(b), we do not reach the district court's rejection of plaintiff's standing argument based upon an alleged "double derivative" action. *See Mendell*, [1988-89] Fed. Sec. L. Rep. (CCH) ¶ 94,086 at 91,087.

III Plaintiff's Standing as a Noteholder Under Fed. R. Civ. P. 60(b)

In light of our reversal of the November 9, 1988 order and subsequent judgment of dismissal gives plaintiff his requested relief, plaintiff's appeal of the motion brought pursuant to Rule 60(b) is to some extent mooted. Nevertheless, we write to affirm the district court's denial of the Rule 60(b) motion in order to emphasize that plaintiff's purchase of a senior subordinated note of International did not provide grounds to vacate the district court's initial order.

The relevant portions of Rule 60(b) provide that "upon such terms as are just, the court may relieve a party . . . from a final judgment [or] order . . . for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . or (6) any other reason justifying relief from the operation of the judgment." Fed. R. Civ. P. 60(b). Motions under Rule 60(b) are addressed to the sound discretion of the district court and are generally granted only upon a showing of exceptional circumstances. *Nemaizer v. Baker*, 793 F.2d 58, 61 (2d Cir. 1986).

Plaintiff argues that he purchased the International note "as soon as it occurred to plaintiff's counsel (1) that any security holder of International could maintain a 16(b) action *and* (2) that notes of International were available to be purchased." We agree with the district court that counsel's ignorance of the law on this point cannot form the basis for relief under subdivision (1) of Rule 60(b). *See id.* at 62-63. Nor can we say that the district court abused its discretion when it denied relief under subdivision (6) of Rule 60(b). Plaintiff's acquisition of a note following an adverse ruling on his claim to standing as a shareholder did not present the kind of "extraordinary" circumstance that mandates relief to avoid an "extreme and undue hardship." *See Ackermann v. United States*, 340 U.S. 193, 199 (1950); *Matarese v. LeFevre*, 801 F.2d 98, 106 (2d Cir. 1986), *cert. denied*, 480 U.S. 908 (1987).

As a noteholder of International, plaintiff clearly has standing to bring a § 16(b) claim in International's behalf. *See* 15 U.S.C. § 78p(b). Yet his newly acquired noteholder status does not afford grounds to vacate an order premised on his status as a former shareholder.

CONCLUSION

The district court's order entered May 24, 1989 is affirmed. Its order entered November 9, 1988 and the subsequent judgment of dismissal entered January 17, 1989 are reversed and the case is remanded to the district court for further proceedings consistent with this opinion.

MILTON POLLACK, *Senior District Judge*, dissenting:

The majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute, § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b).

A corporate merger during the pendency of this suit has sparked the judicial controversy presented to this Court.

Plaintiff was the owner of stock issued by International (Viacom International Inc.) at the time he filed this suit. He seeks to recover short-swing profits of beneficial owners of more than 10% of the stock of International. During the pendency of the suit, the plaintiff ceased being an owner of International stock as the result of a corporate merger. The defendants then moved, successfully, to dismiss the complaint. That dismissal is on appeal to this Court.

International had been organized as a wholly-owned subsidiary of CBS Inc. for the purpose of owning the television program distribution and cable television businesses of CBS. The CBS interest in International was distributed to the CBS stockholders on a pro rata basis. Some time later, Arsenal Holdings Inc. ("Holdings") was organized for the purpose of acquiring International in a merger transaction which had a business purpose. A wholly-owned subsidiary of Holdings was merged with and into International, and, as a result of the merger, International remained a viable corporate entity but became an indirect, wholly-owned subsidiary of Holdings. Holdings changed its name to Viacom, Inc.

("Viacom"). Each share of Viacom stock, including plaintiff's stock, was converted into the right to receive (i) $ 43.20 and (ii) certain percentages of preferred and common stock of Viacom.[1] Plaintiff accepted the conversion and received cash and Arsenal Holdings (now called "Viacom") stock in the exchange.

Refined to simpler understanding of the implication of the corporate merger, it appears that the plaintiff ceased to be a shareholder of International; he had exchanged his holdings in the issuer, International, for cash and preferred and common stock of Arsenal Holdings Inc., which had become the 100% owner of International in the merger. Under the merger exchange the previously outstanding stock of International was cancelled, including plaintiff's shares. In this state of affairs, under the explicit language of § 16(b), the right to bring a § 16(b) suit on behalf of International, the issuer, was limited to either International, the original issuer, or Viacom, its new sole stockholder.

Thus the grounds of difference between the majority of the Court and this dissent are that the plaintiff no longer satisfies the plain statutory requirement—ownership of securities of the issuer.

Prior to the holding of the majority herein, it was axiomatic that an "owner of any security of the issuer" must continue to be a stockholder of the issuer throughout a § 16(b) lawsuit. *See Herrmann v. Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987) ("As a threshold matter . . . plaintiffs must establish that they have been . . . shareholders *throughout* this litigation."); *Rothenberg v.*

1 Excluded from the conversion were dissenting shares and shares held by Viacom, by International, or by a subsidiary of Viacom.

United Brands Co., [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691 (S.D.N.Y.) ("to continue to maintain a derivative action in the right of a corporation, plaintiff must have and *maintain his standing* throughout the litigation."), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("the law requires that to maintain a derivative action under section 16(b) a plaintiff must have and *maintain his standing* as a shareholder at the commencement of the law suit and throughout the litigation."), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982) [Emphases supplied].

This Circuit as well as other circuits likewise have denied standing to sue to a § 16(b) plaintiff who has ceased his stock ownership in the issuer regardless of whether he voluntarily sold his interest or because he was cashed out in a merger transaction. *See Rothenberg v. United Brands Co.*, [1977-78] Fed. Sec. L. Rep. at 91,692 ("Here, we hold only that the requirement of § 16(b) that the plaintiff be the owner of any security of the issuer is not satisfied where plaintiff loses his security owner status [by a statutory short form merger] and thus any proprietary interest in the issuer during the pendency of the action."); *Portnoy v. Kawecki Berylco Indus.*, 607 F.2d 765, 767 (7th Cir. 1979) ("When the plaintiff filed his § 16(b) action, he was an owner of a security of the issuer (KBI). However, he lost that status five days later [when he was cashed out in a merger], and consequently, we are of the opinion that he lost the standing that he had as an owner of KBI stock.").

Those holdings follow traditional rulings in other contexts. Once a plaintiff loses his status as the owner of stock in the issuer, the terminated ownership does not

present a case or controversy for the exercise of judicial power; the claims by a terminated owner are not justiciable any longer. "The rule in federal cases is that an actual controversy must be extant at all stages . . . , not merely at the time the complaint was filed." *Preiser v. Newkirk*, 422 U.S. 395, 401 (1975). "[I]t is not enough that there may once have been a controversy at the time the suit was commenced if subsequent events have put an end to the controversy." *Prudent Publishing Co. v. Myron Mfg. Corp.*, 722 F. Supp. 17, 22 (S.D.N.Y. 1989). For other cases that become moot in the course of litigation, see *Leuer v. Jafco, Inc.*, 375 U.S. 301, 306 n.3 (1964); *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1936); *Stokes v. Village of Wurtsboro*, 818 F.2d 4 (2d Cir. 1987).

The majority holding that a *former* security holder of the issuer who has been divested of his securities by a merger transaction during the pendency of a suit should continue to be qualified to sue is predicated on a perceived necessity to effectuate the statutory policy behind § 16(b). That policy has been described as "to protect the 'outside' stockholders against at least short-swing speculation by insiders with advance information." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). This result has been urged on the Court by the SEC in its *amicus curiae* brief and would implement a rule, lately proposed by the SEC but never adopted, designed to invest a *former* stockholder with continued authority to sue. The proposed rule was floated by the SEC in 1988, revised in 1989, as a proposed definition of the term "owner." *See* Ownership Reports and Trading by Officers, Directors and Principal Shareholders, 53 Fed. Reg. 49997 at 50013 (Dec. 13, 1988) ("To preserve Congress' intent, the pro-

posed rules would provide standing to the former public shareholders whose equity securities have been acquired in a business combination or similar corporate transaction over which the individual shareholder has no control."); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 54 Fed. Reg. 35667 at 35678 (Aug. 29, 1989) ("In response to comment received, the Commission reproposes a more limited definition. The revised proposed definition would extend standing only to former security holders who had filed suit before surrendering their securities.").[2]

The majority of this Court, as well as the SEC, point to the fact that plaintiff is now a shareholder of the parent corporation, Viacom, as further support for the plain extension of the scope of the statute, citing *Blau v. Oppenheim*, 250 F. Supp. 881, 884 (S.D.N.Y. 1966). Reliance on *Blau*, however, is misplaced; it was factually, materially, different. In *Blau*, the issuer was merged out of existence, leading to the argument there made that if a successor was not permitted to sue under § 16(b) no other party would be available to vindicate the policy of the statute. 250 F. Supp. at 886. In the

2 Certainly, the proposed rules do not govern this case, *see Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989) ("[t]hough the Commission has recently proposed a new rule . . . which would extend § 16(b) liability . . ., thereby changing existing law, . . . the proposed rule does not govern the present case."), *cert. denied*, 58 U.S.L.W. 3427 (1990), although the majority urges that they be given persuasive weight. *See Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988) ("The SEC's insights [regarding the materiality standard under Rule 10b-5] are helpful, and we accord them due deference."). In *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977), the Supreme Court observed, however, that "[the SEC's] presumed 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants."

present case, however, ownership of the issuer passed to Viacom, and Viacom, as the sole shareholder of the issuer, remained in position, if need be, to vindicate the purpose of the statute to pursue recovery of short-swing profits of an insider.

The infirmity of *Blau* is highlighted by a careful study of the facts there presented; these were:

Oppenheim was a director of Van Winkle, a listed company, who engaged in short swing transactions and was thus subject to § 16(b) liability at the instance of security holders of Van Winkle. Plaintiff was not an owner of any security of Van Winkle at any time during its existence. Van Winkle was dissolved in its merger into M & T Chemicals, Inc., and all its assets were transferred to M & T in exchange for stock in American Can Co. Blau thereafter bought stock in American Can which, by then, owned 100% of the stock of M & T. Blau sued Oppenheim as a director of Van Winkle under § 16(b) purporting to act as the "owner of any security of the issuer." The District Judge sustained the claim of Blau, a stockholder of American Can, against Oppenheim for short-swing transactions in stock of Van Winkle on a theory that Van Winkle's assets were now in M & T. However, American Can was the stockholder of M & T, not Blau, but this was passed over by the District Judge. To effectuate the conceived purpose of § 16(b), only American Can should have been accorded status to sue, not Blau. The decision of the District Judge was never reviewed or analyzed by appeal. The public policy arguments pressed in *Blau* could only be made by ignoring the obligatory statutory requirement of stock ownership in the issuer. *Blau* granted standing

to a non-owner, rather than to American Can itself, the sole holder of a security of the successor to Van Winkle.

Blau was mentioned by this Circuit and contrasted with *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25, 25 (2d Cir.) ("In *Blau* the issuer had been merged out of existence. . . . [and] the short swing-profits illegally gained would never have been recovered. In contrast, the issuer here, Sea-Land, survived the merger and remains a viable corporate entity. Because Sea-Land remains a viable corporate entity, it or its shareholder, CSX [the parent], can bring an action under section 16(b) to recover the short-swing profits allegedly gained.") (citations omitted), *cert. denied*, 109 S. Ct. 125 (1988). That comment is directly apposite here.

Two other circuit courts which have addressed this issue have refused to extend the statutory qualification to former shareholders of the issuer either when the issuer remains a viable corporate entity, *see Portnoy*, 607 F.2d at 769 (7th Cir. 1979), or when the issuer was merged out of existence. *See Lewis v. McAdam*, 762 F.2d 800, 804 (9th Cir. 1985) (per curiam) ("We hold that where a corporation is merged out of existence by the wholly owned subsidiary of another corporation, the parent corporation is not an 'issuer' within the meaning of section 16(b). Similarly, a shareholder of the parent corporation cannot be considered an 'owner of any security of the issuer' and accordingly lacks standing to bring a section 16(b) action.").

The SEC itself recognizes that qualifying former shareholders to sue, either judicially or by rule-making,

is a marked departure from the pre-existing jurisprudence under § 16(b). *See* 53 Fed. Reg. at 50013 ("Currently, the plaintiff is required to hold these shares [in the issuer] throughout the legal process.") (citing *Portnoy*, *supra*.); *Id*. ("Where the issuer continues to exist as a wholly-owned subsidiary, . . . the courts have uniformly denied standing to former shareholders and shareholders of the parent.") (citing *Untermeyer*, *infra*; *Lewis*, *supra*; *Portnoy*, *supra*.).

It is a frequently stated principle of statutory construction that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. *See National Railroad Passenger Corp. v. National Assoc. of Railroad Passengers*, 414 U.S. 453, 458 (1974). "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." *Botany Mills v. United States*, 278 U.S. 282, 289 (1929). In short, the remedies created in § 16(b) are the exclusive means to enforce the obligation imposed by the Act. *Nat'l Railroad Passenger Corp.*, 414 U.S. at 458.

Congress simply has not delegated to the courts the authority to qualify a "former" owner as an "owner of any security of the issuer." While I agree with the statement in *Blau*, 250 F. Supp. at 884, that "[t]he courts, particularly in our circuit, have consistently interpreted section 16(b) in 'the broadest possible' terms in order not to defeat its avowed objective," the case authorities have also taught that: "We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement." *Lewis v. McAdam*, 762 F.2d 800, 804 (9th Cir. 1985) (citing

Badaracco v. Commissioner, 464 U.S. 386, 398 (1984)); *see also*, *Badaracco*, 464 U.S. at 401 ("If the result contended for by petitioner is to be the rule, Congress must make it so in clear and unmistakable language."); *TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting the statute."); *Blau v. Lehman*, 368 U.S. 403, 411 (1962) ("Congress is the proper agency to change an interpretation of the [1934] Act unbroken since its passage, if the change is to be made."); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("the statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)"), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 109 S. Ct. 125 (1988).

The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.[3]

Further, the narrow private cause of action granted by § 16(b) militates strongly against our attributing to Congress a willingness to allow a more expansive enforcement of the statute. The remedy encompasses not former stockholders of the issuer but only stockholders. As did the Seventh Circuit, we should "reject the plaintiff's invitation to draft 'judicial legislation' to grant him standing." *Portnoy*, 607 F.2d at 768.

Accordingly, I would affirm the order and judgment appealed from.

3 Several times in the past decade or so Congress has legislated amendments to the 1934 Act. *See e.g.*, Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 98-376, 98 Stat. 1265 (1988); Shareholder Communications Act of 1985, Pub. L. No. 99-222, 99 Stat. 1737 (1985); Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984); Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977); Domestic & Foreign Investment Improved Disclosure Act of 1977, Pub. L. No. 95-213, 91 Stat. 1498 (1977).

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Incorporated, and, alternatively, Viacom International, Incorporated,

Plaintiff,

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INCORPORATED, CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT INCORPORATED, VIACOM INCORPORATED, AND VIACOM INTERNATIONAL, INCORPORATED

Defendants.

OPINION AND ORDER

APPEARANCES

IRVING MALCHMAN
Kaufman Malchman Kaufman & Kirby
919 Third Avenue
New York, New York 10022
(212) 371-6600
Attorneys for Plaintiff

EDWIN MISHKIN
(James W. Pharo, of counsel)
Cleary, Gottlieb, Steen & Hamilton
One State Street Plaza
New York, New York 10004
(212) 344-0600
Attorneys for Defendants other than Viacom Incorporated, and Viacom International, Incorporated

MICHAEL B. MUKASEY, U.S.D.J.

Plaintiff Ira L. Mendell, as owner of stock in Viacom, Inc. (Viacom), sues to recover allegedly illegal profits made when the common stock of Viacom International, Inc. (International), a wholly-owned subsidiary of Viacom, was improperly traded by defendants Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, and Helston Investment, Inc. (collectively referred to as defendants). Plaintiff alleges that defendants violated § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982), and he seeks disgorgement of the allegedly ill-gotten gains. Defendants move for summary judgment on plaintiff's securities law action, claiming that plaintiff lacks standing to sue under § 16(b). Fed R. Civ. P. 56. Because, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defendants, their motion is granted.

During 1986, defendants collectively owned more than 10% of International's common stock, making them "principal stockholders" in International. 15 U.S.C. § 78p(a) (1982). As principal stockholders, their purchases and sales of International securities were subject to certain restrictions. 15 U.S.C. § 78p(b) (1982). For example, under § 16(b), if during any six month period, defendants bought International stock for less than they sold it, they would be liable to International for the difference. Alternatively, if International did not sue, one of International's shareholders could sue on behalf of the corporation. 15 U.S.C. § 78p(b) (1982). Plaintiff alleges that in four months, from July to October 1977, defendants made approximately $11,000,000 in allegedly illegal profits from trades in International common stock, and he seeks return of that money to International.

Although plaintiff owned International securities when the allegedly illegal trades occurred, he does not own International securities now. In 1987, plaintiff sold his stake in International to Arsenal Acquiring Corp., which bought out International stockholders for a combination of cash and

stock in Arsenal's parent corporation, known then as Arsenal Holdings, Inc. When Arsenal Acquiring Corp. held over 50% of International's voting securities, it merged itself into International. At the conclusion of that merger, International was a wholly owned subsidiary of Arsenal Holdings, Inc. Shortly thereafter, Arsenal Holdings, Inc. changed its name to Viacom, and plaintiff's shares in Arsenal Holdings, Inc. became Viacom shares.

Defendants assert that plaintiff cannot prosecute this action because he does not own International securities any longer. Defendants are correct. Suits to disgorge ill-gotten gains under § 16(b) may be prosecuted only by the issuer itself or the holders of its securities. *Untermeyer* v. *Valhi, Inc.*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 109 S. Ct. 175 (1988); 15 U.S.C. § 78p(b) (1982). *See Herrmann* v. *Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987); *Rothenberg* v. *United Brands Co.*, [1977-1978] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691 (S.D.N.Y.), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977). Therefore, because plaintiff no longer owns any International securities, he may not sue under § 16(b) to recover any allegedly illegal profits made by defendants in their trades of International securities.

Moreover, in this case, plaintiff's status as a stockholder of Viacom, International's sole shareholder, does not confer upon him standing to sue on Viacom's behalf. Illegal profits made through trading an issuer's securities are recoverable by the issuer's parent or holders of the parent's securities, but only when the issuer is no longer a viable corporate entity. *Blau* v. *Oppenheim*, 250 F. Supp. 881, 886 (S.D.N.Y. 1966). In those cases, the defunct corporation must rely on its successor to vindicate its rights under § 16(b). *Untermeyer*, 841 F.2d at 25, *citing Blau*, 250 F. Supp. at 886. In contrast, where the issuer remains a viable corporate entity at the time of the suit, the issuer or holders of its securities are still capable of suing under § 16(b), and there is no need to rely on the parent or its securities holders to vindicate the issuer's rights. Therefore, in this case, if International is a viable corporate entity, only it and its stockholders may sue defendants under § 16(b). *Untermeyer*, 841 F.2d at 25.

International is a viable corporate entity. It has survived its merger with Arsenal Acquiring Corp., and it continues to have a shareholder, Viacom. Therefore only International or the sole holder of its securities, Viacom, may sue defendants under § 16(b). *Untermeyer*, 841 F.2d at 25. Because plaintiff is neither International nor Viacom, he does not have standing to sue defendants under § 16(b).

In addition, plaintiff cannot meet his standing burden by asserting that he sues derivatively on behalf of Viacom, which in turn sues derivatively on behalf of its subsidiary International, which allegedly has a § 16(b) cause of action against defendants. Section 16(b)'s standing requirements are specific, and must be strictly construed. *See Foremost-McKesson, Inc.* v. *Provident Sec. Co.*, 423 U.S. 232, 251-52 (1976). If successful, plaintiff would enlarge the class of persons entitled to sue under § 16(b) to include shareholders of a shareholder. However, shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b). Accordingly, the fact that plaintiff calls his suit a "double derivative" action on behalf of International fails to give plaintiff standing.

As a final matter, because this suit is brought on behalf of International and Viacom, and those corporations are mere nominal defendants in this action, summary judgment for defendants disposes entirely of plaintiff's claims and requires dismissal of this action as to International and Viacom.

So Ordered:

/s/ Michael B. Mukasey
Michael B. Mukasey
U.S. District Judge

Dated: November 8, 1988

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 CIVIL 0085 MBM
Filed January 17, 1989

IRA L. MENDELL, in behalf of Viacom, Incorporated, et ano

Plaintiff

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., ET AL

Defendants

JUDGMENT

Defendants having moved for summary judgment and the said motion having come before the Honorable Michael B. Mukasey, U.S.D.J., and the Court thereafter on November 9, 1988, having handed down its opinion and order (#63376), granting defendants' motion, it is,

ORDERED, ADJUDGED AND DECREED: That the complaint be and it is hereby dismissed.

/s/ RAYMOND F. BURGHARDT
Clerk

DATED: New York, N.Y.
January 17, 1989

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON __________.

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Incorporated, and, alternatively, Viacom International, Incorporated,

Plaintiff,

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INCORPORATED, CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELTON INVESTMENT, INCORPORATED, VIACOM INCORPORATED, AND VIACOM INTERNATIONAL, INCORPORATED,

Defendants.

OPINION AND ORDER

APPEARANCES:

IRVING MALCHMAN
Kaufman Malchman Kaufmann & Kirby
919 Third Avenue
New York, New York 10022
(212) 371-6600
Attorneys for Plaintiff

EDWIN MISHKIN
(Michael S. Sommer, of counsel)
Cleary, Gottlieb, Steen & Hamilton
One State Street Plaza
New York, New York 10004
(212) 344-0600
Attorneys for Defendants other than nominal defendants Viacom International, Inc. and Viacom, Inc.

Hughes, Hubbard & Reed
One Wall Street
New York, New York 10005
(212) 709-7000
Attorneys for Defendants
Viacom International, Inc. and
Viacom, Inc.

MICHAEL B. MUKASEY, U.S.D.J.

In a prior Opinion and Order, I dismissed the securities-law action of plaintiff Ira L. Mendell, brought on behalf of Viacom, Inc. (Viacom), and Viacom International, Inc. (International), against defendants Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, Helton Investment, Inc., Viacom, and International. *Mendell* v. *Gollust*, No. 87 Civ. 0085 (MBM) (S.D.N.Y. Nov. 8, 1988). Mendell now seeks relief from that Order, and the judgment of dismissal. Fed. R. Civ. P. 60(b). For the reasons discussed below, Mendell's motion is denied.

In his original suit, Mendell claimed that defendants violated § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982) allegedly by making illegal trades in International common stock. However, Mendell did not have standing to sue defendants because he did not own International securities. Slip. op. at 3-5. On January 9, 1989, Mendell bought approximately $1000.00 worth of International securities which were issued in June or July of 1988. Affidavit of Irving Malchman Exhibit C. The judgment dismissing the action then was issued on January 17, 1989.

Mendell asserts that his belated purchase of International securities gives him standing to sue defendants, and therefore he seeks to have the dismissal of his earlier claim vacated. Mendell asserts that he suffered dismissal because of a technical defect in his prior suit, and that with the correction of

that defect, he should now be permitted to pursue his claim. Mendell's position is without merit.

Rule 60(b) provides in relevant part that "upon such terms as are just, the court may relieve a party . . . from a final judgment [or order] . . . for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . (6) any other reason justifying relief from the operation of the judgment."

Mendell appears to argue, although not explicitly, that dismissal of his claim was a result of "mistake, inadvertence, surprise, or excusable neglect." Fed. R. Civ. P. 60(b)(1). Specifically, Mendell argues that he bought an International security "as soon as it occurred to plaintiff's counsel (1) that any security holder of International could maintain a 16(b) action here and (2) that notes of International were available to be purchased." Reply Memorandum in Support of Plaintiff's Motion for an Order Pursuant to [Fed. R. Civ. P.] 60(b) Relieving Plaintiff of Court's Order and Judgment of Dismissal at 4. In a footnote, Mendell explains that "[i]f asked, plaintiff's counsel would have answered, after a little research, that any security holder can maintain a 16(b) action. Thinking of it in the first instance is something else, however." *Id.* at n.1. Counsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1). *E.g.*, *Nemaizer* v. *Baker*, 793 F.2d 58, 62-63 (2d Cir. 1986). Therefore, Mendell's motion cannot be granted under Fed. R. Civ. P. 60(b)(1).

Mendell seeks to vacate his dismissal also under Fed. R. Civ. P. 60(b)(6). Unlike Fed. R. Civ. P. 60(b)(1), this subsection "does not particularize the factors that justify relief, but . . . provides courts with authority '. . . to vacate judgments whenever such action is appropriate to accomplish justice,' *Klapprott* v. *United States*, 335 U.S. 601, 614-15 (1949), while also cautioning that it should only be applied in 'extraordinary circumstances,' *Ackermann* v. *United States*, 340 U.S. 193[, 199] (1950)." *Liljeberg* v. *Health Servs. Acquisition Corp.*, 108 S. Ct. 2194, 2204 (1988); *Matarese* v. *LeFevre*, 801 F.2d 98, 106 (2d Cir. 1986) (motion should be granted when its denial would work an "extreme and undue

hardship"), *cert. denied*, 480 U.S. 908 (1987). Mendell's argument is that as a noteholder of International, he now has standing to maintain his claim against defendants. When compared with the jailed, penniless, physically ill petitioner in *Klapprott* who defaulted despite his best efforts to avoid that result, or the petitioner confronting the appearance of grave judicial impropriety in *Health Servs. Acquisition Corp.*, Mendell is not the victim of "extraordinary circumstances" such that he will suffer "extreme and undue hardship" if relief is denied. His new basis for standing arises from an after-the-fact strategem devised following an adverse opinion, and is intended to make it appear that he, in common with others, has suffered cognizable injury. Therefore, Mendell's position is much closer to that of the petitioner in *Ackermann*, who had the merits of his case heard, and whose rights were extinguished because he made a counselled, "voluntary, deliberate, free, [and] untrammeled choice," 340 U.S. at 200, that ended up being a tactical error.

Mendell has failed to meet the applicable legal standards for vacating my earlier Order dismissing his claim. Accordingly, his motion for relief from that Order and the judgment dismissing his action is denied.

So Ordered:

/s/ Michael B. Mukasey
Michael B. Mukasey
U.S. District Judge

Dated: May 23, 1989
New York, New York

APPENDIX E

UNITED STATES DISTRICT COURT
Southern District of New York

Civil Action No.
87 Civ. 0085 (MBM)

Ira L. Mendell, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.

Plaintiff,

vs.

Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, Helston Investment Inc., Viacom Inc., and Viacom International, Inc.

Defendants.

AMENDED COMPLAINT
JURY TRIAL DEMANDED

First Claim for Relief

(Single Derivative Action on Behalf of New Viacom)

Plaintiff for his amended complaint alleges upon information and belief, except as to those allegations which pertain to the plaintiff, as follows:

1. Plaintiff brings this First Claim in behalf of and for the benefit of Viacom, Inc. ("new Viacom") against the other defendants herein for violation of Sections 16(b) and 20 of the Securities Exchange Act of 1934 ("Exchange Act").

2. This Court has jurisdiction of this action pursuant to Section 27 of the Exchange Act.

3. Many of the acts and transactions constituting the violations of law complained of occurred in this District and the

principal executive office of Viacom International, Inc. ("old Viacom") is located herein.

4. (a) As the result of a corporate restructuring that occurred on or about June 3, 1987 ("restructuring"), old Viacom became the wholly owned subsidiary of new Viacom.

(b) As a result of the restructing [*sic*], the shareholders of old Viacom received 17% of the common stock of new Viacom, 17% of the preferred stock of new Viacom (both the common and preferred stock of new Viacom are listed and traded on the American Stock Exchange), and cash.

(c) Prior to the restructuring, new Viacom was a shell corporation incorporated in Deleware [*sic*] for the purpose of acquiring old Viacom. The only significant asset of new Viacom is old Viacom.

5. Section 16(b) of the Exchange Act provides *inter alia*, that the issuer may recover from the beneficial owner of more than ten per centum of any equity security of the issuer any profit realized from any purchase or sale, or any sale and purchase, of any equity security of the issuer within any period of less than six months.

6. For the purposes of Section 16(b), all defendants (except old and new Viacom) constituted a single or one beneficial owner of more than ten per centum of the common stock of old Viacom.

7. At all times referred to herein, the common stock of old Viacom was listed and traded on the New York Stock Exchange, a national securities exchange, and was subject to and regulated by Section 16(b) of the Exchange Act.

8. Old Viacom was a corporation organized and existing under the laws of the State of Ohio.

9. Prior to the restructuring, plaintiff Ira L. Mendell owned 1,200 shares of the common stock of old Viacom continuously at all times material to the bringing of this action As a result of the restructuring, plaintiff is now a stockholder of new Viacom.

10. Defendant Coniston Partners is a New Jersey limited partnership ("Coniston I"). The address of Coniston I is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of investment partnership. Coniston I has five general partners as follows:

(a) General Partner: A general partnership defendant Gollust, Tierney and Oliver ("GTO"), 500 Park Avenue, New York, New York 10022.

The principal business of GTO is that of investment banking.

The general partners of GTO are:

(i) Defendant Keith R. Gollust, 500 Park Avenue, New York, NY 10022

(ii) Defendant Paul E. Tierney, Jr., 500 Park Avenue, New York, NY 10022

(iii) Defendant Augustus K. Oliver, 500 Park Avenue, New York, NY 10022

(iv) Defendant Gollust & Tierney, Inc., a New Jersey corporation ("G&T")

(b) General Partner: defendant G & T. The address of G & T is 330 Hobart Avenue Short Hills, NJ 07078.

The principal business of defendant G & T is that of investment banking.

Executive officers and directors of G & T are:

(i) Defendant Keith R. Gollust, Managing Director

(ii) Defendant Augustus K. Oliver, Managing Director

(c) General Partner: defendant Keith R. Gollust

(d) General Partner: defendant Paul E. Tierney, Jr.

(e) General Partner: defendant Augustus K. Oliver

11. Defendant, Coniston Institutional Investors, is a New Jersey limited partnership ("Coniston II"). Coniston II has one general partner, namely defendant GTO. The address of

Coniston II is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of investment partnership.

12. Defendant Baker Street Partners is a New Jersey limited partnership ("Baker"). Baker has one general partner, namely defendant GTO. The address of Baker is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of an investment partnership.

13. Defendant WJB Associates, is a Bahamian partnership ("WJB"). WJB has one general partner, namely defendant GTO. Its principal business is that of investment partnership.

14. Defendant Helston Investment Inc. is a Panamanian corporation ("Helston") for which defendant G & T serves as investment manager. Defendant Gollust is an officer and director of Helston. Helston is also a wholly-owned subsidiary of and under the control of Coniston International Corporation, a Panamanian corporation of which defendants Oliver, Tierney and Gollust are directors.

15. In connection with all the transactions alleged in this complaint, the defendants, except old and new Viacom ("Coniston defendants"), operated as a single unit and as a single beneficial owner within the meaning of Section 16(b) and made their official filings with the Securities and Exchange Commission ("SEC") as a unit, and through the identical agent and representative and attorney in fact and in a single document and made all their short-swing purchases and sales in conformity with and pursuant to identical advice, information, management and direction. They have referred to themselves collectively as "Coniston Partners" in filings with the SEC and in releases to the press and to the financial community, both in the transactions alleged herein and in other similar transactions and dealings.

16. The Coniston defendants purchased and sold the common stock of old Viacom as herein alleged on a unitary basis under and pursuant to the advice, direction and management of defendants Gollust, Tierney and Oliver as a firm (defendant GTO), as a corporation (defendant G&T) and as individuals.

17. The Coniston defendants, while a ten per centum beneficial owner of old Viacom's common stock, purchased approximately 700,000 shares of old Viacom's common stock between in or about July, 1986 and September, 1986 at prices ranging from approximately $27 per share to no more than $40 per share.

18. In October, 1986 the Coniston defendants, while a ten per centum beneficial owner of old Viacom's common stock, sold approximately 700,000 shares of old Viacom's common stock for approximately $43 per share plus a price protection clause which would permit the Coniston defendants to benefit further and make additional profits should the purchaser or purchasers of said 700,000 shares from the Coniston defendants sell said shares at a higher price and under certain other circumstances. Said sale was made by the Coniston defendants in a single sales agreement to a single purchaser and was made under the advice, management and direction of Gollust, Tierney and Oliver as a firm (defendant GTO), as a corporation (defendant G&T) and as individuals.

19. By reason of their purchase and sale of old Viacom's common stock within a period of less than six months and while a ten per centum beneficial owner of old Viacom's common stock, the Coniston defendants realized short term profits in violation of Section 16(b) in the amount of approximately $11,000,000.

20. By virtue of the restructuring, old Viacom has become new Viacom's subsidiary so that new Viacom is now the issuer within the meaning of Section 16(b).

21. On or about July 10, 1987 a demand was made upon both old and new Viacom and their Boards of Directors to institute and prosecute an action against the Coniston defendants pursuant to Section 16(b) for the acts and transactions alleged herein, but they have failed to bring such action.

22. This is not a collusive action to confer upon a court of the United States jurisdiction of an action which it would not otherwise have.

ALTERNATIVE SECOND CLAIM FOR RELIEF

(Double Derivative Action On Behalf of Old Viacom)

23. Plaintiff repeats and realleges the facts set forth in the First Claim for Relief.

24. This Second Claim for Relief is brought, alternatively to the First Claim, as a double-derivative action on behalf of old Viacom.

WHEREFORE, plaintiff demands judgment in behalf of new Viacom upon the First Claim for Relief or, alternatively, in behalf of old Viacom upon the Second Claim for Relief, awarding damages in the approximate amount of $11,000,000 against the Coniston defendants, and each of them, jointly and severally, for said short-swing profits made by said Coniston defendants in the purchase and sale of old Viacom's common stock; and awarding plaintiff the costs of this suit, including reasonable attorneys', accountants' and experts' fees and other disbursements, together with such further relief as the Court may deem appropriate.

JURY DEMAND

Plaintiff respectfully demands a trial by jury.

Dated: New York, New York
March 11, 1988

KAUFMAN MALCHMAN KAUFMANN
& KIRBY

By: /s/ IRVING MALCHMAN
(A Member of the Firm)
919 Third Avenue
New York, New York 10022
Tel. (212) 371-6600

Attorneys for Plaintiff

(2)

No. 90-659

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc.,

Respondents.

BRIEF FOR RESPONDENT MENDELL IN OPPOSITION

IRVING MALCHMAN
KAUFMAN MALCHMAN KAUFMANN & KIRBY
919 Third Avenue
New York, NY 10022
(212) 371-6600

Attorney for Respondent Mendell

20

QUESTION PRESENTED

Whether a shareholder loses his standing under 16(b) where (1) the shareholder commenced his 16(b) action on behalf of the issuer months before the business restructuring in question, (2) in such restructuring, the issuer became the wholly owned subsidiary of a parent corporation, which was a shell corporation formed for the purpose of acquiring the issuer, with the issuer being the parent corporation's only asset, and (3) as a result of such restructuring, the shareholder exchanged his stock in the issuer for cash and stock of the parent corporation so that the shareholder has a continuing financial interest in the 16(b) action?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

No. 90-659

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY and OLVIER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

-v-

IRA L. MENDELL, in behalf of VIACOM INC. and, alternatively, VIACOM INTERNATIONAL INC.,

Respondents.

BRIEF FOR RESPONDENT MENDEL IN OPPOSITION

COUNTER-STATEMENT OF THE CASE

The facts are fully set forth in the Second Circuit's opinion herein (909 F.2d 724).

The original complaint, filed on January 6, 1987, was brought in behalf of Viacom International, Inc. ("International"), whose stock had been listed and traded on the New York Stock Exchange, to recover short-swing profits made in violation of 16(b) against the defendants herein (other than the nominal defendants, International and Viacom, Inc.) (Id., at 725-6). As the result of a business restructuring that occurred on or about June 3, 1987 ("restructuring"), International became the wholly owned subsidiary of Viacom, Inc. ("Viacom") (Id. at 726).

As a further result of the restructuring, the shareholders of International received cash and also 17% of the common and preferred stock of Viacom (Ibid.). The common and preferred

stock of Viacom are listed and traded on the American Stock Exchange.

Prior to the restructuring, Viacom was a shell corporation incorporated for the purpose of acquiring International (Ibid.). The only significant asset of Viacom is International (Ibid.). A subsidiary of Viacom merged into International, which thereby became the wholly owned subsidiary of Viacom (Ibid.).

As a result of the restructuring, plaintiff herein is now a shareholder of Viacom (Ibid.).

REASONS FOR DENYING THE PETITION

I. THERE IS NO CONFLICT IN DECISIONS

Petitioners predicate their petition upon a claimed conflict between the decision herein by the Second Circuit and the decisions in Portnoy v. Kawecki Berylco Inds., 607 F.2d 765 (7th Cir. 1979) (2-1 decision) and Lewis v. McAdam, 762 F.2d 800 (9th Cir. 1985) (per curiam). There is no basis for petitioners' claims of a conflict.

Unlike here, in neither Portnoy nor Lewis was the plaintiff ever a shareholder of the issuer.

In Portnoy, the initial issuer, whose shareholders were cashed out, became the subsidiary (second tier subsidiary) of he first tier subsidiary of a public corporation. Plaintiff therein was a

shareholder of the public grandparent.

Similarly, in Lewis, the initial issuer, whose shareholders were also cashed out, ceased to exist upon its merger into the subsidiary of a parent corporation. Plaintiff therein was a shareholder of the public parent corporation.

The Second Circuit in its opinion herein appropriately distinguished Portnoy and Lewis as follows (Id. at 730-1):

> "Contrary decisions of our sister circuits are similarly distinguishable. See Lewis, 762 F.2d at 801 (plaintiff shareholder of parent but never held stock in the issuer or its surviving subsidiary); Portnoy, 607 F.2d at 767-68 (cashout merger left plaintiff with no continuing financial interest in the litigation; plaintiff's alternative status as a shareholder in the grandparent corporation gave no standing for §16(b) suit on behalf of the issuer). In the case at bar, the conversion of International stock

> into Viacom stock presents a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer. We conclude, therefore, that under those unique circumstances the cases cited by defendants are neither controlling nor persuasive."

Nor is there any intra-Circuit conflict with Untermeyer v. Valhi, Inc., 665 F. Supp. 297 (S.D.N.Y. 1987), aff'd mem., 841 F.2d 1117 (2d Cir. 1988), aff'd on reh'g, 841 F.2d 25 (2d Cir. 1988), cert. denied 109 S.Ct. 175, or with Rothenberg v. United Brands Co., [1977-78 Transfer Binder] Fed. Sec. L. Rept. (CCH) ¶ 96,045 at 91,690 (S.D.N.Y. 1977) aff'd mem., 573 F.2d 1295 (2d Cir. 1977), as claimed by petitioners.

Since Judge Cardamone authored the opinion of the Second Circuit herein and was also a member of the panel in Untermeyer, petitioners' claim of a

conflict with Untermeyer requires Judge Cardamone to have been in conflict with himself. There is no basis for imputing to Judge Cardamone any such basic self-contradiction.

In Untermeyer, the shareholders of the initial issuer (Sea-land) were cashed out by another public corporation (CSX) and Sea-Land became the wholly owned subsidiary of CSX. Both Sea-Land and CSX had been totally separate and independent companies and the common stock of both Sea-Land and CSX had been listed and separately traded on the New York Stock Exchange.

The opinion herein thus distinguished Untermeyer, as follows (Id. at 730):

> "[Untermeyer]...dealt with a plaintiff who owned stock of the parent corporation, but who never owned stock of the company that issued the shares traded in contravention of §16(b). 665 F. Supp. at 298. Thus, even without

a merger, the Untermeyer plaintiff would not have had standing. In contrast, plaintiff here brought a valid §16(b) suit while he was a current shareholder of the issuer, and but for the merger standing would not be in issue here." (emphasis in original)

Finally, respecting Rothenberg, the Second Circuit in its opinion herein also appropriately distinguished that decision (Id. at 730):

> "In Rothenberg v. United Brands Co., also cited by the district court, the shareholders received cash in the merger instead of securities. The crucial factor considered by the trial court was that in a cashout merger the former shareholders maintain no continuing financial interest in the litigation. See Rothenberg, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,692. In the present case all former International shareholders obtained, as a result of the merger, shares of International's parent corporation, and plaintiff, as one of them, continues to have at least an indirect financial interest in the outcome of this lawsuit. Two additional reasons caution against an overbroad application of Rothenberg: That decision noted that even if plaintiff had standing the §16(b) claim failed on the merits, see id. at 91,693-94; and the court's standing analysis was premised on an analogous application of Rule 23.1 which, as noted above, does not govern shareholders bringing §16(b) claims. Id. at 91,691-92."

This case involves a unique set of facts so that there is no basis for petitioners' claim of a conflict in decisions.

II. THIS CASE INVOLVES A UNIQUE AND NON-RECURRENT SET OF FACTS AND HAS BEEN CORRECTED DECIDED

The Second Circuit explicitly referred in its opinion herein to the "novel situation" and "unique circumstances" of this case (Id. at 730, 731). No other case involves the situation where, as here, the restructuring in question occurred during

the pendency of a properly brought 16(b) action and the former shareholders of the issuer received in the restructuring stock of the parent (a shell corporation formed to acquire the issuer which became the parent's only asset) so that the former shareholders of the issuer have a continuing interest in maintaining A 16(b) suit in behalf of the issuer.

This singularly unique case therefore does not present any significant federal question which calls for this Court to grant certiorari.

The Second Circuit properly held, in this distinctive case, that the threshold procedural question of standing under 16(b), as distinguished from questions of substantive liability under 16(b), should be "determined by whether the policy behind the statute is best served by

allowing the claim." (Id. at 729) and that the broad meaning of the statutory language ("owner" of securities which language is not modified by any limiting expression) "better accords with the remedial purpose of the statute." (Id. at 730).

A long and unbroken line of decisions liberalizes procedural requirements in 16(b) cases. As stated by Judge Irving Kaufman in Epstein v. Shindler, 26 F.R.D. 176, 178 (S.D.N.Y. 1960), in disallowing a counterclaim against the issuer in a 16(b) action: "'it is plain ... that it [16(b)] was primarily intended as an instrument of a statutory policy of which the general public is the ultimate beneficiary. Congress did not intend procedural restrictions to hamper such policy.'",

quoting from Benisch v. Cameron, 81 F. Supp. 882, 884 (S.D.N.Y. 1948).

See, also, Blau v. Mission Corp., 212 F.2d 77, 79 (2d Cir. 1954), cert. denied, 347 U.S. 1016 (after-acquired shareholder may sue under 16(b) and requirements of Rule 23.1 in a derivative action that the complaint allege that "the plaintiff was a shareholder ... at the time of the transaction of which he complains" is inapplicable in 16(b) action); Magida v. Continental Can Co., 231 F.2d 843, 847-848 (2d Cir. 1956), cert. denied, 351 U.S. 972 (fact that there may be champertous relationship between plaintiff and his attorney is not a defense to a 16(b) action); Park & Tilford, Inc. v. Schulte, 160 F.2d 984, 988 (2d Cir. 1947), cert. denied, 332 U.S. 761 (if issuer does sue under 16(b),

intervention is freely granted to a shareholder "to guard against even the appearance of any concerted action"); Pellegrino v. Nesbit, 203 F.2d 463, 467 (9th Cir. 1953) ("any stockholder has a right to institute 16(b) suit if the corporation fails to do so, regardless of the good faith or reasonable business judgment of the board of directors."); Prager v. Sylvestri, 449 F. Supp. 425, 429 (S.D.N.Y. 1978) (demand requirement of 16(b) exists only for benefit of the issuer, so that the defendant insider does not have standing to assert lack of demand as a defense).

As stated by the Second Circuit herein: "A §16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy." (Id. at 728) In

this regard, the Second Circuit further stated: "we cannot help but note that the incorporation of Viacom and the merger proposed occurred after plaintiff's §16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present." (Id. at 731)

Finally, the SEC submitted an amicus brief below that supported the standing of respondent Mendell under 16(b) in this case. The decision of the Second Circuit herein thus has the support of the SEC.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

IRVING MALCHMAN
KAUFMAN MALCHMAN KAUFMANN & KIRBY
919 Third Avenue
New York, New York 10022
(212) 371-6600

Attorney for Respondent Mendell

Dated: November 21, 1990

(3)

No. 90-659

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

Edwin B. Mishkin
(*Counsel of Record*)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners

52

QUESTION PRESENTED

Whether the court below erred in ruling that the phrase in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), granting standing to bring an action thereunder to "the owner of any security of the issuer" can be interpreted to include a "former owner" of such securities, and thereby holding that Respondent could maintain an action under Section 16(b) on behalf of an issuer of securities after he had ceased to own any of its securities?

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.* In addition to these parties, the Securities and Exchange Commission participated in the proceedings before the United States Court of Appeals for the Second Circuit below as *amicus curiae.*

---

* The following information is provided pursuant to Rule 29.1 of this Court: Gollust, Tierney and Oliver, Inc., the successor by merger to Petitioner Gollust & Tierney, Inc., is owned by Keith R. Gollust and Paul E. Tierney, Jr., and has no subsidiaries; Petitioner Helston Investment Inc. is wholly owned by Coniston North Atlantic International Corp. and has no subsidiaries.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Constitutional Provision

Statutes and Rules

Legislative History and Administrative Materials

Miscellaneous

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-659

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

This brief is respectfully submitted by petitioners Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates and Helston Investment Inc. ("Petitioners"), seeking reversal of a decision of the United States Court of Appeals for the Second Circuit, entered in this proceeding on July 25, 1990, which reversed an order of the United States District Court for the Southern District of New York grant-

ing summary judgment in favor of Petitioners on the ground that Respondent lacked standing to maintain this action.

OPINIONS BELOW

The opinions delivered in the Court of Appeals for the Second Circuit (1a[1]) are reported at 909 F.2d 724 (2d Cir. 1990). The Opinion and Order of the District Court for the Southern District of New York granting summary judgment in favor of Petitioners (30a) is reported unofficially at [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086 (S.D.N.Y. Nov. 8, 1988). The Final Judgment of the District Court (34a) is unreported. The Opinion and Order of the District Court denying Respondent's motion pursuant to Fed. R. Civ. P. 60(b) for relief from the Final Judgment (35a) is reported unofficially at [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. May 23, 1989).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 25, 1990. The Petition for a Writ of Certiorari was filed on October 23, 1990, and was timely under 28 U.S.C. § 2101(c). The Petition for a Writ of Certiorari was granted by an order filed on January 7, 1991, which is reported unofficially at 111 S. Ct. 669 (1991). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves Section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78p(b), which provides:

1 References to the Appendices to the Petition for a Writ of Certiorari are cited "__a." References to the Joint Appendix are cited "JA __."

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

15 U.S.C. § 78p(b). The phrase "such beneficial owner, director, or officer" in Section 16(b) refers to Section 16(a) of the Exchange Act, 15 U.S.C. § 78p(a), which imposes certain reporting obligations on "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to [Section 12 of the Exchange Act, 15 U.S.C. § 78*l*], or who is a director or an officer of the issuer of such security . . . ."

STATEMENT OF THE CASE

A. Facts

Respondent Ira L. Mendell ("Respondent") filed his original Complaint herein in behalf of Viacom International Inc. ("International")[2] in January 1987, alleging that he was then a holder of common stock of International, a company whose shares were listed on the New York Stock Exchange and registered under Section 12 of the Exchange Act, 15 U.S.C. § 78*l*, and that he was entitled to assert a Section 16(b) claim on behalf of International against Petitioners arising out of their purchases and sales of International stock in 1986.[3] Respondent did not allege that Petitioners were true "insiders" subject to Section 16(b) in the sense that they had been officers or directors of International or in any way controlled or influenced the affairs of International. Instead, the basis for Respondent's claim is that "[f]or the purposes of Section 16(b), all defendants . . . constituted a single or one beneficial owner of more than ten per centum of the common stock of" International, who, among other things, "operated as a single unit and as a single beneficial owner within the meaning of Section 16(b) and made their official filings with the Securities and Exchange Commission . . . as a unit." Amended Complaint ¶¶ 6, 15; 40a, 42a.[4]

2 Respondents International and Viacom, Inc., its parent company, were nominal defendants in the District Court below and nominal appellees before the Court of Appeals, and have not actively participated in this action.

3 The allegations relating to Petitioner's alleged liability under Section 16(b), as opposed to Respondent's standing, were essentially identical in the original Complaint, which is not reproduced in the Appendices to the Petition for a Writ of Certiorari or in the Joint Appendix, and the Amended Complaint, which is reproduced in the Appendices to the Petition for a Writ of Certiorari.

4 The Complaint did not allege that any one Petitioner in fact owned ten percent or more of International's common stock at any time. Rather it contended that, because Petitioners "made their official filings with the [Commission] as a unit, and through the identical agent and representative and attorney in fact and in a single document" (Amended Complaint ¶ 15; 42a)—*i.e.*, were required to report their combined shareholdings as a single "beneficial owner" for purposes of Section 13(d) of the Exchange Act, 15 U.S.C. § 78m(d)—they were also a single "beneficial owner" of such shares for purposes of Section 16. Respondent's position on this issue has been rejected repeatedly by the courts. *See Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990); *Rothenberg v. Jacobs*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,199 (S.D.N.Y. Jan. 11, 1989), *aff'd mem.*, 888 F.2d 126 (2d Cir. 1989); *C.R.A. Realty Corp. v. Goodyear Tire & Rubber Co.*, 705 F. Supp. 972, 973-78 (S.D.N.Y.), *aff'd mem.*, 888 F.2d 125 (2d Cir. 1989). The Securities and Exchange Commission has recently adopted new rules that for the first time would apply the "beneficial ownership" rules under Section 13(d) to determine whether a person is a beneficial owner of more than ten percent of any class of equity securities under Section 16. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-28869, at 122-24 (Feb. 8, 1991) (newly adopted Rule 16a-1(a)(1), to be codified at 17 C.F.R. § 240.16a-1(a)(1)). However, transactions occurring prior to the May 1, 1991 effective date of the new rule would be governed by prior law. *Id.* at 94.

In June 1987, International was acquired by Arsenal Holdings, Inc. (now named Viacom Inc. and referred to herein as "Viacom")—an entity controlled by National Amusements, Inc. ("National Amusements")—through a merger with a subsidiary of Viacom pursuant to which International became a wholly owned subsidiary of Viacom and the shareholders of International received a combination of cash and Viacom securities in exchange for their shares of International. *See* Proxy Statement of International/Prospectus of Viacom, dated May 4, 1987, annexed to Affidavit of Edwin B. Mishkin, verified May 27, 1988 ("Proxy Statement") at 1-2; JA 14-JA 16; Viacom Annual Report on Form 10-K for the year ended December 31, 1987, at 2; JA 31. As a consequence of the merger, Respondent ceased to be a shareholder of International, becoming instead a security holder of its new parent corporation, Viacom.

Respondent's Amended Complaint, filed in behalf of International and, alternatively, Viacom in March 1988, alleged that as a result of the merger, Respondent was now a holder

of stock of Viacom. Amended Complaint ¶ 9; 40a. The Amended Complaint also alleged that by reason of the merger, Viacom became "the issuer within the meaning of Section 16(b)." *Id.* at ¶ 20; 43a. Finally, realizing that he may be held to lack standing, Respondent alleged alternatively that his action was brought as a "double-derivative" lawsuit on behalf of International. *Id.* at ¶ 24; 44a.

As the record demonstrates, the acquisition of International by Viacom was not in any way a reaction to Respondent's lawsuit. Instead, it was a bona fide arm's-length business transaction between previously unaffiliated parties that resulted from events that began months before Respondent's suit was filed. *See* Proxy Statement at 9-12; JA 18-JA 24 (describing a series of bids for International beginning in September 1986 that were made by two competing bidders, one led by senior managers of International and the other by National Amusements). Moreover, the transaction was not an "involuntary" one; rather it was a consensual merger that was required to be, and was, approved by a majority vote of holders of International common stock, over 80 percent of which was held by shareholders who were independent of National Amusements or its affiliates (Proxy Statement at 5; JA 18). Dissenting shareholders were afforded appraisal rights under Ohio law, Proxy Statement at 16; JA 25-JA 26, which Respondent did not exercise.

Following the consummation of the merger and the filing of the Amended Complaint, Petitioners moved for summary judgment on the ground that Respondent no longer had standing to sue because he had ceased to be a holder of securities of International—the issuer on whose behalf the suit was brought—and that Respondent could not escape his lack of standing by asserting a "double-derivative" action.

B. The District Court's Standing Decision

On November 8, 1988, the District Court, relying on prior Second Circuit precedent, issued an Opinion and Order holding that "[b]ecause, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defendants, their motion [for summary judgment] is granted." *Mendell v. Gollust*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086, at 91,086 (S.D.N.Y. Nov. 8, 1988); 31a.

As an initial matter, the District Court noted that Section 16(b) actions may be prosecuted "only by the issuer itself or the holders of its securities," *id.* at 91,086; 32a, and because Respondent no longer owned any International securities, he had no standing to maintain a Section 16(b) action on behalf of International, *id.* at 91,087; 33a.

The District Court then turned to whether Respondent had standing to sue as a security holder of the new parent corporation of the issuer. Noting that International remained a viable corporate entity, and that it had a shareholder—Viacom—the District Court held that the explicit language of Section 16(b) limited the right to sue to either International or Viacom. *Id.* at 91,087; 33a. Respondent, being neither, therefore lacked standing to maintain his action under Section 16(b). *Id.*[5]

---

5 The District Court also rejected Respondent's attempt to circumvent the express standing requirements of Section 16(b) by labelling the lawsuit a "double-derivative" action, stating that "shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b)." *Id.* at 91,087; 33a.

After filing his first notice of appeal from the District Court's November 8, 1988 Opinion and Order, but before any action was taken on Respondent's appeal, in January 1989, Respondent decided on a new tactic: to regain standing to sue, he went into the market and purchased a $1000 bond of International that was part of an issue that had been offered to the public in July 1988, well before the District Court's November 8, 1988 Opinion and Order. Respondent advised the Second Circuit of his new "status" as a security holder of International and of his intention to make a motion to vacate the District Court's judgment, and the parties thereafter stipulated to withdraw Respondent's appeal from active consideration by the Second Circuit in order to allow Respondent to make his motion pursuant to Fed. R. Civ. P. 60(b), which was made in March 1989.

On May 23, 1989, the District Court denied Respondent's Rule 60(b) motion stating that his "after-the-fact stratagem devised following an

C. The Court of Appeals' Decision

After oral argument was held before the Court of Appeals, that court requested the Securities and Exchange Commission (the "Commission") to submit an *amicus curiae* brief setting forth its views on Respondent's standing under Section 16(b). *Mendell v. Gollust*, 909 F.2d 724, 726 (2d Cir. 1990); 6a. The Commission responded by submitting a brief in which it acknowledged that decisions of the other Courts of Appeals (as well as previous cases from the Second Circuit itself) had uniformly denied standing to plaintiffs in situations similar to that of the Respondent here, but nevertheless argued in favor of Respondent's standing principally in order to vindicate what it viewed as the "broad remedial purpose" of Section 16(b). Brief for the Commission, *amicus curiae*, at 2, *Mendell v. Gollust*, 909 F.2d 724 (2d Cir. 1990) (No. 89-7068).

On July 25, 1990, the Court of Appeals panel, by a 2-1 decision, reversed the District Court's November 9, 1988 ruling granting Petitioners summary judgment based on Respondent's lack of standing.[6]

adverse opinion" was not a sufficient basis, under Rule 60(b)(6), to vacate the District Court's prior order and judgment. *Mendell v. Gollust*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,051 (S.D.N.Y. May 23, 1989); 38a. Further, in response to Respondent's counsel's plea that he did not think of having Respondent purchase the International bond sooner, the District Court stated that "[c]ounsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1)." [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,050; 37a. Respondent thereupon filed a second notice of appeal challenging the District Court's denial of his Rule 60(b) motion.

6 The Court of Appeals did not reach the question of the District Court's rejection of Respondent's standing argument based upon an alleged "double derivative" action, 909 F.2d at 731; 18a, but affirmed the District Court's denial of Respondent's Rule 60(b) motion (*see* note 5, *supra*), *id.* at 731-32; 18a-19a. These issues were not raised or addressed in the Petition for a Writ of Certiorari or in Respondent's Brief in Opposition, and are not addressed in this Brief.

1. The Majority Opinion

The opinion of the majority made clear that the focal point of its decision was not the actual language of the standing provisions of Section 16(b) at issue here, but what it perceived to be the broad remedial purposes underlying Section 16(b). The opinion began by discussing the legislative history of Section 16(b) and the purposes of the statute, 909 F.2d at 726-27; 7a-8a, and reviewed prior case law involving the construction of Section 16(b) purportedly indicating that where Section 16(b)'s terms are susceptible of differing constructions, it should be construed broadly, *id.* at 727-28; 8a-10a.

Turning to the standing requirements of Section 16(b), the majority stated that "the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim." *Id.* at 729; 12a. Although the majority acknowledged that "the amount or value of a [Section 16(b)] plaintiff's holdings or his motives for bringing suit are not relevant" to the question of standing, *id.* at 729; 12a, it also reasoned that, in cases such as this, standing could be determined on the basis of an assessment of the likelihood that the statute would be enforced by the available plaintiffs, *id.* at 729; 13a (in cases where original issuer survives merger as wholly owned subsidiary of a new parent corporation, "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders").

Only after concluding that, as a matter of policy, plaintiffs such as Respondent here should be granted standing in Section 16(b) cases did the majority actually address the contention that the statutory language did not support this conclusion. *Id.* at 730-31; 15a-16a. In what amounted to nothing more than judicial redrafting of legislation, the majority stated that, because the reference to the "owner of any security of the issuer" in Section 16(b) was not modified by the word "current," the statute did not specifically bar the maintenance of Section 16(b) suits by "former" owners of the issuer's securities. *Id.* at 730; 15a.

The majority completely avoided any analysis of the reasoning of earlier decisions of other courts (including the Second Circuit itself) that had uniformly held that a Section 16(b) plaintiff must remain a security holder of the issuer throughout the litigation, and that if a security holder of the issuer ceases for any reason to own such securities, or if the securities held are those of a parent or grandparent corporation rather than the original issuer, he does not have standing to maintain the action. Although its decision was plainly inconsistent with those earlier decisions, the majority sought to distinguish them factually on the ground that this case presents a "novel situation" in that Respondent's shares of the issuer corporation were exchanged for securities of its new parent corporation and therefore the issuer's former shareholders had a "continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730-31; 16a-17a.

Finally, although the record below plainly demonstrated that the acquisition of International by Viacom (a previously unrelated party) was not in any way related to this lawsuit—and Respondent had not even asserted that it was—the majority stated that it could not "help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's § 16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present." *Id.* at 731; 17a.

2. The Dissenting Opinion

In a dissenting opinion, Senior District Judge Milton Pollack (sitting by designation) noted that "[t]he majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute." *Id.* at 732; 20a. The dissent noted that Respondent "no longer satisfies the plain statutory requirement—ownership of securities of the issuer," *id.* at 732; 21a, and that the decision of the District Court was consistent with prior case law of the Second Circuit and with rulings from the Seventh and Ninth Circuits—the only other circuits to address the issue—as well as with "traditional rulings in other contexts" holding that continuing ownership of securities of the issuer is required in order to present a justiciable case or controversy. *Id.* at 733; 22a-23a.

The dissent also noted that the Commission itself recognizes "that qualifying former shareholders to sue, either judicially or by rule-making, is a marked departure from the pre-existing jurisprudence under § 16(b)." *Id.* at 735; 26a-27a. The dissent observed that "Congress simply has not delegated to the courts the authority to qualify a 'former' owner as an 'owner of any security of the issuer,' " *id.* at 735; 27a, and "[t]here is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words 'owner of any security of the issuer' was meant to include or even could include one who is no longer the owner of any security of the issuer," *id.* at 735; 28a. Accordingly, the dissent urged the court to " 'reject [Respondent's] invitation to draft "judicial legislation" to grant him standing.' " *Id.* at 736; 29a (citation omitted).

SUMMARY OF ARGUMENT

Prior to the decision of the Court of Appeals below, it had been well-established that a plaintiff bringing a Section 16(b) action in behalf of an issuer must not only have the status of "the owner of any security of the issuer," as required by the statute, at the commencement of the suit, but must also maintain that status throughout the litigation. This "continuous ownership requirement" is compelled by the structure and legislative history of the statute, which demonstrate a clear intent to vest control of such litigation only in parties who have a financial interest in the outcome; by the narrowly circumscribed standing provisions of Section 16(b), which are unique among the civil liability provisions of the federal securities laws in excluding the Commission from the enforcement scheme, rendering it anomalous for a private party without a

financial interest to maintain a suit that the Commission could not bring itself; by principles applicable to shareholder derivative litigation generally, under which a shareholder is permitted, by virtue of his financial interest in the outcome, to step into the shoes of the corporation to seek relief on its behalf; and by the case or controversy requirement of Article III of the Constitution, which requires a plaintiff to have a financial interest in the outcome at all stages of the litigation.

Consistent with the continuous ownership requirement, the language of Section 16(b), which accords standing to "the owner of any security of the issuer," could not be clearer, admitting of no other interpretation than that suit must be brought and maintained by a "current owner." Nevertheless, the Court of Appeals grafted an exception onto the clear words of Section 16(b) to accord standing to "former owners" of securities of the issuer. In order to do so, the Court of Appeals—in the guise of furthering the "policy behind the statute"—distorted the plain words of the statute to create an ambiguity where none existed. The Court of Appeals' judicial legislation violated the well-established principle that, when Congress has spoken clearly, a court may not rewrite the words of the statute to cure a perceived defect in the statutory scheme.

The Court of Appeals' redrafting of Section 16(b) also ignored the Section 16(b) jurisprudence that has long been laid down by this Court. In recognition of the unique status of Section 16(b) as a strict liability statute with harsh consequences even for innocent conduct, this Court has required that its provisions be applied narrowly, with any ambiguities resolved against liability. Indeed, every time this Court has addressed Section 16(b), it has resolved uncertainties concerning the interpretation of the statute *against* liability. Thus, the Court of Appeals only compounded its error by resolving in favor of liability an ambiguity that was of its own making.

The Court of Appeals also plainly erred in asserting that the merger which deprived Respondent of his share ownership in the issuer presented a "danger of . . . intentional

restructuring to defeat the enforcement mechanism incorporated in the statute." The record unequivocally shows that the merger involved here was a bona fide arm's-length transaction with a valid business purpose and was completely unrelated to this lawsuit, and Respondent has not even asserted otherwise. The statutory enforcement scheme was also unimpeded by the merger, since the two parties with standing to sue under the statute—International and Viacom—were free to pursue the matter if they so chose. Moreover, even if, in cases such as this, neither the issuer nor its sole shareholder chooses to pursue an action under Section 16(b), any danger of abuse of inside information is precluded by the numerous other statutory provisions prohibiting insider trading that may be enforced by the Commission or injured parties.

Finally, the Court of Appeals completely failed in its attempt to create a factual distinction between this case and the other cases that have uniformly denied standing to parties who do not have security holder status in the issuer, either at or after the commencement of the litigation. There is simply no principled basis to distinguish this case from any other case denying standing to plaintiffs who lost ownership of their securities in the issuer by a corporate merger or who sought to commence or maintain a Section 16(b) suit as security holders of a corporation that is not in fact the issuer of their securities but is instead the parent (or grandparent) of that issuer.

ARGUMENT

THE COURT OF APPEALS WRONGLY HELD THAT RESPONDENT HAS STANDING TO MAINTAIN THIS ACTION UNDER SECTION 16(b)

The specific issue before the Court of Appeals was whether, under Section 16(b), an owner of a security of the issuer has standing to continue a Section 16(b) action once he no longer owns any security of the issuer. The broader issue presented in this case is whether the federal courts have the power to expand upon the unambiguous language of Section 16(b) to accord standing to sue to one who does not meet the statutory requirement in order to further what those courts perceive to be the remedial purposes of the statute. The Court of Appeals majority below, in an unprecedented opinion, incorrectly answered both questions in the affirmative.

A. A Security Holder Of The Issuer Who Commences An Action Under Section 16(b) Must Maintain His Status As A Security Holder Of The Issuer Throughout The Litigation

Prior to the decision of the Court of Appeals majority below, the courts had been unanimous in requiring that a plaintiff bringing a Section 16(b) action in behalf of the issuer must not only have the status of "the owner of any security of the issuer," as required by the statute, at the commencement of the suit, but must also maintain that status throughout the litigation. *See Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045, at 91,691-92 (S.D.N.Y. May 11, 1977) (plaintiff lost standing to maintain Section 16(b) action after suit commenced when his shares in the issuer were sold to parent of issuer in short-form "squeeze-out" merger), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767 (7th Cir. 1979) (plaintiff lost standing to maintain Section 16(b) action after his shares in the issuer were "cashed out" in merger, despite ownership of securities of new grandparent of issuer both before and after merger);

Staffin v. Greenberg, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation."), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982); *see also Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam) (no standing to shareholder of parent of surviving corporation who commenced suit after issuer was acquired through merger); *Untermeyer v. Valhi*, 665 F. Supp. 297 (S.D.N.Y. 1987) (same), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988); *Herrmann v. Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987) (in remanding to district court, court notes that as a "threshold matter" plaintiffs "must establish that they have been [the issuer's] shareholders throughout this litigation").

Notwithstanding this overwhelming precedent, the Court of Appeals majority below asserted that the continuous ownership requirement "is not mandated either by the statutory language or by the cited cases." 909 F.2d at 730; 15a. The majority's assertion flies in the face of the structure and legislative history of the statute, principles generally applicable to derivative litigation and constitutional principles governing standing.

The requirement of continuous ownership after the commencement of the suit is implicit in the statutory requirement that "[s]uit . . . may be instituted . . . by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter." Exchange Act § 16(b), 15 U.S.C. § 78p(b). This scheme entrusts Section 16(b) actions not brought by an issuer only to persons who have the statutorily defined financial interest in the outcome of the litigation. The fact that "the owner of any security of the issuer" may not only commence an action that an issuer has failed to bring, but may step in during the course of an action that was brought initially by the issuer if the issuer fails to pursue

it "diligently," makes clear that security owner status, and the financial incentive it provides, is important at *all* stages of the litigation, not just at the threshold. The statute simply cannot be read to require that a plaintiff need be a security owner of the issuer only at the instant he brings the suit and that he may continue the suit after ceasing to have the statutory status.

The legislative history of Section 16(b) fully supports this reading of the statute. Thomas G. Corcoran, one of the principal draftsmen of the Exchange Act, indicated in testimony before Congress that the purpose of the provision giving standing to security holders was to provide an incentive to sue to parties who would benefit financially from a recovery. Responding to concerns expressed that Section 16(b) would be difficult to enforce, Corcoran stated:

> . . . . You have said to all of the stockholders of the company, "You can recover any of this profit *for your own account*, if you find out that any such transactions are going on."
>
> * * * *
>
> The fact that the *stockholders, with an interest*, are permitted to sue to recover that profit for the benefit of the company, puts anyone doing this particular thing, in the position of taking risk that *somebody, with a profit motive* will try to find out.
>
> The section is a deterrent, and you will in some cases actually catch violators.

Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 136-37 (1934) (emphasis added). Thus, in providing standing not just to the issuer, but also to its security holders, Congress sought to ensure that such actions are maintained by parties with a financial interest in the outcome of the action—a purpose that is completely defeated if a plaintiff who does not have that status is permitted to maintain the suit.

The continuous ownership requirement is also consistent with Section 16(b)'s enforcement scheme. Where Congress thought it appropriate to expand standing to enforce securities laws beyond the parties who would benefit financially from recovery, it has done so by giving the Commission enforcement authority. *See, e.g.*, Investment Company Act of 1940 § 36(b), 15 U.S.C. § 80a-35(b) (standing to sue advisor and others for breach of fiduciary duty given solely to the Commission and security holders); Insider Trading Sanctions Act of 1984, Exchange Act § 21A, 15 U.S.C. § 78u-1 (action for violation of prohibition on insider trading may be brought by the Commission). Section 16(b), however, is one of the few areas in which the Commission has *no* enforcement authority whatsoever, even under the broad delegation of authority to the Commission under Exchange Act § 21, 15 U.S.C. § 78u, to take action against violations of the Exchange Act, since Section 16(b) cannot be the basis for a "violation."[7] *See, e.g.*, *Commonwealth Energy System*, SEC No-Action Letter (publicly available Nov. 2, 1989) (WESTLAW, FSEC-NAL database) ("Because enforcement of Section 16(b) rests exclusively with private litigants and the

7 Section 16(b) is not worded as a prohibition on short-swing trading. The operative provision simply provides that "any profit realized by [any officer, director or ten percent beneficial owner] from any purchase and sale, or any sale and purchase, of any equity security of [the] issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . ." Congress expressly considered and rejected a provision in the original version of the Exchange Act introduced in the Senate that would have provided criminal liability for short-swing trading. S. 2693, 73d Cong., 2d Sess. § 15(b) (1934) ("It shall be unlawful for any director, officer, or [five percent beneficial or record owner] . . . (1) To purchase any . . . security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction . . . extending over a period of less than six months shall inure to and be recoverable by the issuer . . . ."). While this Court has suggested that the elimination of criminal liability may have arisen from difficulties of proving the mental elements of the offense, *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 248 n.23 (1976), it is also consistent with an intention to narrow the enforcement scheme only to those parties who are financially affected by such transactions.

courts, and not with the Commission, the [Commission staff] does not render advice with respect to liability under Section 16(b).''); Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,599 n.21, 42 SEC Docket 464, 467 n.21 (Dec. 2, 1988) (''Unlike other provisions of the Exchange Act, Section 16(b) is enforced by shareholders bringing derivative actions on behalf of the issuer, rather than by the Commission or by shareholders directly pursuing claims for damages.''). It would be anomalous for Congress to have intended that a private person no longer having a financial interest in the controversy could maintain a Section 16(b) action when the agency charged generally with enforcement of the securities laws could not itself maintain such an action.

The continuous ownership requirement is also consistent with the approach applied generally in shareholder derivative actions, which provided the model for the enforcement scheme chosen by Congress with respect to Section 16(b). *See, e.g., Rothenberg, supra*, at 91,691-92 (Section 16(b)'s continuous ownership requirement analogous to requirement imposed in cases addressing standing to maintain shareholder derivative actions in federal court); *Portnoy, supra*, 607 F.2d at 767; *Staffin, supra*, 509 F. Supp. at 840. As the court noted in *Portnoy*:

> The underlying rationale of these cases is that because a shareholder will receive at least an indirect benefit (in terms of increased shareholder equity) from any corporate recovery, he has an adequate interest in vigorously litigating the claim. A non-shareholder or one who loses his shareholder interest during the course of the litigation may lose any incentive to pursue the litigation adequately.

607 F.2d at 767.

The continuous ownership requirement is also compelled by constitutional standing requirements under the case or controversy provisions of Article III. As this Court stated in

Gladstone, Realtors v. Village of Bellwood, 441 U.S. 91 (1979), Article III's case or controversy requirement imposes a constitutional limit on Congress's power to grant standing so that ''[a] plaintiff must always have suffered 'a distinct and palpable injury to himself' that is likely to be redressed if the requested relief is granted.'' *Id.* at 100 (quoting *Warth v. Seldin*, 422 U.S. 490, 501 (1975)). Since a security holder bringing a Section 16(b) action need not have been injured by the alleged conduct—indeed, lower courts have not required that Section 16(b) plaintiffs own securities of the issuer at the time of the transactions at issue, *see Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953)—this constitutional requirement that all parties have a stake in the outcome can only be fulfilled if the plaintiff possesses an investment interest in the issuer the value of which may be enhanced by a recovery.

This constitutional requirement must be met not only at the threshold of the litigation, but throughout the course of the litigation. *See Lewis v. Knutson*, 699 F.2d 230, 236-37 (5th Cir. 1983) (addressing continuous ownership requirement in shareholder derivative litigation: ''[T]he constitutional limitation continues to arise when . . . plaintiffs' injury has not fully developed into a claim or has passed.''). As the dissent noted below, ''Once a plaintiff loses his status as the owner of stock in the issuer, the terminated ownership does not present a case or controversy for the exercise of judicial power . . . . 'The rule in federal cases is that an actual controversy must be extant at all stages . . . , not merely at the time the complaint was filed.' '' 909 F.2d at 733; 22a-23a (quoting *Preiser v. Newkirk*, 422 U.S. 395, 401 (1975)).

B. The Court Of Appeals Improperly Ignored The Plain Language Of Section 16(b)'s Standing Provisions

Believing that it was unconstrained by the continuous ownership requirement, the majority below grafted an exception onto the clear words of Section 16(b) to accord standing to former owners of securities of the issuer. In so doing, the

opinion below makes clear the virtual exclusive reliance by the majority on its perception of the "policy behind the statute" in interpreting the language "owner of any security of the issuer" to include a person who is no longer such an owner. 909 F.2d at 729; 12a ("In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim."). Although the majority noted the principle that "only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose," *id.* at 728; 9a (citation omitted), it failed entirely to establish what it claimed to be the predicate for its heavy reliance on the policy behind the statute.

The majority's assertion that it was free to consider the policy behind that statute because the relevant language of Section 16(b) allowed alternative constructions, 909 F.2d at 728; 10a (citing *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 424 (1972); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 (1973)), is insupportable. The language of Section 16(b) gives no indication whatsoever that a "former" owner of a security of the issuer may maintain an action. Besides issuers[8] themselves, Congress chose to

8 The importance of adherence to the literal meanings of the words of the statute is underscored by comparing the statutory definition of "issuer" under the Exchange Act, Exchange Act § 3(a)(8), 15 U.S.C. § 78c(a)(8), which is limited strictly to the entity that issues the security involved, with Section 2(11) of the Securities Act of 1933, 15 U.S.C. § 77b(11), which includes in the definition of issuer for certain purposes under that Act "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." *See Portnoy*, 607 F.2d at 767-68 (rejecting plaintiff's request to broaden definition of "issuer" for purposes of Section 16(b) to include parent of issuer: "Congress has spoken clearly. When it wanted a broader definition of issuer, it drafted one."). *Cf. Blau v. Lehman*, 368 U.S. 403, 409-13 (1962) (rejecting broad definition of term "director" under statute as including a partnership of which a director is a partner). The majority below disclaimed any reliance on a broad definition of "issuer" as the basis for Respondent's standing, *see* 909 F.2d at 729; 13a, relying instead on a broad definition of "owner."

provide Section 16(b) standing only to those who are "the owner[s] of any security of the issuer"—a provision that cannot reasonably be read to include "a person who is not now an owner but once was the owner of any security of the issuer."

The majority turned the straightforward statutory language on its head by asserting that, since Congress did not insert the word "current" before the word "owner" in the statute, "former" owners may sue if the court determines that permitting such a suit would advance the remedial purpose of the statute. 909 F.2d at 730; 15a. It must be presumed, however, that when Congress imposes as a condition to standing to bring a lawsuit the requirement that the plaintiff have a specified status, it intends to require that the plaintiff have that status currently, rather than in the past. The use of the qualifier "current" would add nothing.

Contrary to the reasoning of the court below, if Congress had for any reason intended to broaden the standing requirements of Section 16(b) to include former owners, it could easily have done so. *Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam). But Congress authorized only "owners"—not "owners or former owners"—to bring suit under Section 16(b). Nor is there anything in the legislative history remotely indicating that Congress intended such an illogical reading of the word "owner." *See id.* at 804 ("We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading."); dissenting opinion below, 909 F.2d at 735-36; 28a. As this Court has admonished, "congressional silence . . . cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 n.13 (1985).

Under the plain meaning of Section 16(b), only an existing owner of a security of the issuer has standing to commence and maintain such an action. Whatever the merits or demerits of the statute's failure to extend standing to "former" own-

ers of such a security, this limitation "is inherent in the statute as written, and its correction must lie with Congress," not with the courts. *Id.* at 499. As this Court noted in *Blau v. Lehman*, 368 U.S. 403, 413 (1962), in which the Court rejected a prior invitation by the Commission to judicially rewrite Section 16(b)'s scope, "Congress is the proper agency to change an interpretation of the [Exchange] Act unbroken since its passage, if the change is to be made." *See also TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute."); *Lewis, supra*, 762 F.2d at 804 ("We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement.") (citing *Badaracco v. Commissioner*, 464 U.S. 386 (1984)); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("[T]he statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). As the dissent below concluded:

> The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.

909 F.2d at 735-36; 28a-29a (footnote omitted).

C. The Court Of Appeals' Reliance On Perceived Policy In Expanding Upon The Language Of Section 16(b) Contradicts This Court's Long-Established Section 16(b) Jurisprudence

Section 16(b) is unique among the express civil liability provisions of the Securities Act of 1933 (the "Securities Act") and the Exchange Act. While every other express civil liability provision in the Securities Act or Exchange Act "contains a state-of-mind condition requiring something more than negligence," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976), Section 16(b) is, by its terms, a strict liability statute, imposing liability "irrespective of any intention on the part of [the] beneficial owner, director, or officer," Exchange Act § 16(b), 15 U.S.C. § 78p(b). Section 16(b)'s unique standing requirements are consistent with this strict liability approach: it is the only express civil liability provision in the Securities Act or Exchange Act that does not limit standing to persons who purchase or sell securities in connection with the alleged violation.[9] *Cf. Blue Chip Stamps*

---

9 *See* Section 11(a) of the Securities Act, 15 U.S.C. § 77k(a) (liability for material misstatements or omissions in a registration statement; right of action provided for "any person acquiring [a] security"); Section 12 of the Securities Act, 15 U.S.C. § 77*l* (liability for offers or sales of securities in violation of prospectus delivery requirements or by means of prospectus or oral communications that include material misstatements or omissions; right of action for "the person purchasing such security from" the defendant); Section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e) (liability for certain fraudulent and manipulative practices; right of action for "any person who shall purchase or sell any security at a price which was affected by such act or transaction"); Section 18(a) of the Exchange Act, 15 U.S.C. § 78r(a) (liability for false or misleading statements contained in certain documents filed with the Commission; right of action for "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement"); Section 20A(a) of the Exchange Act, 15 U.S.C.

v. Manor Drug Stores, 421 U.S. 723, 734 (1975) (citing Section 16(b) in support of the proposition that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly."). Indeed, as the lower courts have interpreted Section 16(b), a plaintiff need not have owned securities of the issuer at the time of the transactions at issue, and may purchase securities for the very purpose of bringing suit. *See Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953).

Partly in recognition of the broad sweep of Section 16(b), this Court has consistently required that its provisions be interpreted narrowly. Indeed, in every decision by this Court interpreting Section 16(b), this Court has rejected any proposed expansive interpretation of the statute.[10] In *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 251 (1976), this Court noted that Section 16(b) "imposes liability without fault within its narrowly drawn limits." The Court went on to say that "[i]t is inappropriate to reach the harsh result of imposing § 16(b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference." *Id.* at 252; *see also Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 427 (1972) ("[W]e are not free to adopt a construction that not only strains, but flatly contradicts, the words of the statute."). As this Court has previously emphasized, because Section 16(b) imposes a standard of strict liability, it is generally applied with a "mechanical quality." *Reliance Elec.*, *supra*, 404 U.S. at 425.[11]

In ignoring the plain, unambiguous language of the statute, the majority below not only disregarded, but flatly contradicted, the clear mandate of this Court not to construe Section 16(b) expansively even when the language is unclear. Indeed, the majority's statement that "[w]hen the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes," 909 F.2d at 728; 10a, stands on its head this Court's statement in *Foremost-McKesson* that ambiguities are to be resolved against liability.

Moreover, in the two decisions of this Court cited by the majority below as authority for its heavy reliance on the perceived policy underlying the statute, *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and *Reliance Elec.*, *supra*, *see* 909 F.2d at 727-28; 8a-10a, as well as in every other decision of this Court addressing Section 16(b) (*see* note 10, *supra*), this Court actually declined to apply an expansive reading of Section 16(b). As this Court

---

§ 78t-1(a) (liability for insider trading; right of action to "any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class"). In addition, Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), provides a right of action to declare certain contracts made in violation of the Exchange Act void. Although the statute does not set forth an express standing requirement for all actions brought under it, it does provide an express limitations period for certain actions brought "by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security."

10 *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (defendant must be 10% beneficial owner before purchase of securities is subject to Section 16(b); not sufficient that purchase of securities causes defendant to become 10% beneficial owner); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (binding option for defeated tender offeror to sell post-merger securities not deemed a "sale" under Section 16(b) because potential for abuse not present); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972) (Section 16(b) applies only to sales occurring while defendant is 10% beneficial owner; sales occurring after defendant had reduced ownership to 9.96% outside scope of statute); *Blau v. Lehman*, 368 U.S. 403 (1962) (partnership of which director in issuer corporation was a partner could not be held liable under Section 16(b) for profits earned by it in short-swing transactions).

11 This Court has also rebuffed efforts to expand categories of persons entitled to standing under the securities laws. *See, e.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (only purchaser or seller may bring implied action under Exchange Act § 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977) (unsuccessful tender offeror has no standing to sue under Exchange Act § 14(e), 15 U.S.C. § 78n(e)).

noted in *Foremost-McKesson*, *supra*, 423 U.S. at 252, "[i]n neither [*Kern County Land Co.* nor *Reliance Elec.*] did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16(b)."

The weakness of the majority's analysis in relying on perceived policy over the plain language of the statute is highlighted by the inconsistency with which it applies that analysis. In an effort to avoid the effect of prior decisions of other circuits, and of the Second Circuit itself, which held that shareholders who lost their shares in a merger involving the issuer did not have standing under Section 16(b), *see Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767-68 (7th Cir. 1979); *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the majority sought to limit its expansion of the standing requirement to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer." 909 F.2d at 730-31; 16a-17a. This arbitrary, piecemeal expansion of the statute to provide standing to some, but not all, former holders of securities of the issuer (only those who had exchanged their shares for securities in the acquiror of the issuer) completely undercuts the majority's interpretation of the language of the statute as not limited to "current" security holders. If the language of the statute were in fact susceptible of being interpreted as granting standing to those who formerly held securities of the issuer, there is no principled textual basis for distinguishing between those who were cashed out in a merger and those who received, in exchange for their securities in the issuer, securities of the issuer's acquiror. Indeed, nothing would prevent a shareholder who was cashed out in a merger with another public corporation from reinvesting the cash in securities of the acquiror and then renewing his suit—or commencing a new action—to recover under Section 16(b) on behalf of the newly acquired subsidiary. Yet the opinion of

the majority below suggests that such a suit would not be allowed, while a shareholder who received his shares in the acquiring corporation in the acquisition itself could continue his suit. 909 F.2d at 730-71; 16a-17a. This distinction is without any substance and cannot be supported by the language of the statute or by any perceived reason of policy.

The self-contradictory approach of the majority below demonstrates the dangers of embarking on inquiries into perceived policies behind statutes where such inquiries are not justified or compelled by the statutory language—especially where Section 16(b) is concerned. By relying on what it perceived as the sole policy behind Section 16(b) of preventing insider trading, the majority ignored Congress's clear countervailing policy—manifest in the language of the standing provisions of the statute itself—of providing standing for this strict liability statute only to a narrowly, and clearly, defined group of parties. *See Foremost-McKesson*, *supra*, 423 U.S. at 252 ("It is not irrelevant that Congress itself limited carefully the liability imposed by § 16(b).").

The difficulties, and arbitrariness, involved in the essentially legislative task of drawing lines based on perceived policy in this area is also highlighted by the Commission's recent tortured efforts to propose rules that would create exceptions to Section 16(b)'s standing requirements. In its initial proposed Section 16 rule changes announced in 1988, the Commission proposed a rule that would have defined the term "owner of any security of the issuer" for purposes of Section 16 as:

> a beneficial owner of securities of the issuer at the time of suit or, if as a result of a business combination the issuer, at the time of suit, does not have a reporting obligation under Section 13 or 15(d) of the Act with respect to an equity security, a former beneficial owner of the issuer who was required to surrender such securities due to such business combination.

Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333,

42 SEC Docket 464, 503 (Dec. 2, 1988) (proposed Rule 16a-1(h)). The Commission sought to justify this proposed rule—which, in according standing to any former security holder who lost his securities in a merger, whether before or after the suit began, would abrogate not only the continuous ownership requirement, but even the requirement of ownership at the commencement of the suit—on the ground that existing law "undercuts the policing function played by shareholders in Section 16(b) actions." *Id.*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620, 42 SEC Docket at 490.

When the Commission's Section 16 rule changes were reproposed in 1989, the scope of this rule was narrowed considerably in response to public comment so that the term "owner of any security of the issuer" for purposes of Section 16 would be defined as:

> a beneficial owner of securities of the issuer at the time of filing a lawsuit under Section 16(b) of the Act. If as a result of a business combination of the issuer, a beneficial owner of any security of the issuer is required to surrender the securities due to such business combination, such person shall continue to be deemed a beneficial owner until resolution of the lawsuit if the suit was filed prior to the surrender of securities.

Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-27148, 44 SEC Docket 526, 553 (Aug. 18, 1989) (reproposed Rule 16a-1(g)). This change preserved the requirement of ownership of securities at the commencement of the suit, but adopted an exception to the continuous ownership requirement for mergers. Apparently uncomfortable, however, with the new lines it had drawn, the Commission solicited comment as to whether the rule should also permit former shareholders to sue within a specified period after losing their shares in a merger or if they had made a statutory demand on the issuer within a specified period prior to a merger (once again diluting the requirement of ownership at the commencement of the suit), or whether it should require that the plaintiff own securities of the surviving company "[t]o ensure that the plaintiff has a sufficient financial interest in the outcome to warrant an extension of standing."[12] *Id.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,439, at 80,397, 44 SEC Docket at 544.

In formally announcing its final comprehensive rule changes under Section 16 on February 8, 1991, the Commission withdrew from its effort to adopt standing requirements pursuant to its rulemaking authority[13] pending this Court's decision in this case. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-28869, at 87-88 (Feb. 8, 1991). Given the Commission's failure over a two-year period to arrive at satisfactory exceptions to the requirement of ownership at the commencement of the suit and the continuous ownership requirement—indeed, even to articulate a coherent policy for drawing such lines—it is clear that if there are to be any such exceptions, they should be established legislatively and not by the judiciary.[14]

---

12 Significantly, this suggested modification, which would incorporate the financial interest principle underlying Section 16(b)'s standing provisions, would reflect existing law. *See, e.g.*, *Newmark v. RKO General, Inc.*, 425 F.2d 348, 352 n.4 (2d Cir.) (plaintiff security holder of company surviving merger has standing to bring Section 16(b) suit based on pre-merger trading in shares of issuer, which did not survive merger), *cert. denied*, 400 U.S. 854 (1970). Because International was the surviving company in its merger with a subsidiary of Viacom, and because the Respondent did not own securities of International, he would not have had standing if the Commission's suggested modification were incorporated into the rule.

13 The Commission's authority to promulgate for the federal judiciary rules governing the standing of a private plaintiff to maintain an action would appear to be doubtful in any event, but this need not now be resolved since the Commission has withdrawn its proposed rule.

14 The majority opinion below cited the Commission's views, including the proposed rules under Section 16(b), in support of its result, although it acknowledged that "the proposed rule is inapplicable in the case at hand." 909 F.2d at 730; 14a (citing *Mayer v. Chesapeake Ins.*

D. Adherence To The Clear Language Of Section 16(b) Will Not Undercut Enforcement Of The Statute

The majority below sought to buttress its departure from the language of Section 16(b) by asserting that the reorganization of International as a wholly owned subsidiary of Viacom presented a "danger of . . . intentional restructuring to defeat the enforcement mechanism incorporated in the statute." 909 F.2d at 731; 17a. This contention is incorrect both as a factual matter in this case and as a policy matter generally.

The record unequivocally shows that the merger was a bona fide transaction with a valid business purpose—facilitating the acquisition of International by National Amusements, a previously unrelated party. The merger was the culmination of an "auction" process by which National Amusements competed with a group led by senior management of International in making a series of bids for the company beginning in September 1986—four months before this action was brought and one month before the transactions allegedly underlying Respondent's claim. Moreover, the transaction was not an "involuntary" one, as suggested by

Co., 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990)). In light of the Commission's lack of enforcement authority under Section 16(b), however, *see* Part A, *supra*, the Court of Appeals' deference to the views of the Commission was misplaced. *Cf. Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565 (1980) (deference is to be given "to the views of the administrative entity appointed *to apply and enforce a statute*") (emphasis added). Moreover, the Commission's recent, waffling attempt at rulemaking in this area, described above, hardly constitutes the kind of "binding, consistent, official interpretations of its statute over a long period of time" that would justify the invocation of the "administrative deference" rule. *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977). Moreover, as the dissent noted below, " '[the Commission's] presumed "expertise" in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants.' " 909 F.2d at 734 n.2; 24a (quoting *Piper v. Chris-Craft Indus., Inc.*, *supra*, 430 U.S. at 41 n.27).

the majority opinion below. 909 F.2d at 731; 17a. Rather, it was a consensual merger that was required to be, and was, approved by the holders of a majority of International common stock, over 80 percent of which was held by shareholders who were independent of National Amusements or its affiliates. In short, the record overwhelmingly demonstrates that the transaction was not in any way related to this lawsuit, and could not possibly have been undertaken for the purpose of "defeat[ing] the enforcement mechanism incorporated in the statute."[15] *See* dissenting opinion below, 909 F.2d at 732; 20a (merger had a valid business purpose).

To the extent the statement of the majority below reflected a policy concern that denial of standing in merger situations would "defeat the enforcement mechanism incorporated in the statute," it is also completely unfounded. The enforcement mechanism chosen by Congress—suit by the issuer or the owner of a security of the issuer—remains unimpeded, since both of these parties (in this case, International and Viacom) are completely free to pursue any valid pre-merger Section 16(b) claim. The fact that those parties have chosen not to pursue the claim does not justify permitting a former stockholder of the issuer to do so.

Similarly, there is no empirical basis for the assertion of the majority below that "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders." 909 F.2d at 729; 13a. A Section 16(b) "insider" may well be a person who is not in fact an "insider," including one who purchases more than ten percent of the stock of the corporation without the consent, or even in defiance, of its management. Particularly in merger transactions—which are frequently preceded by unsolicited

15 In addition, dissenting shareholders were entitled to elect to receive the "fair cash value" of their shares, Proxy Statement at 16; JA 25-JA 26, which could include the shareholders' pro-rata portion of any Section 16(b) claims held by the company, *see Portnoy*, *supra*, 607 F.2d at 770 n.2 (dissenting opinion) (shareholder appraisal rights in connection with merger may take into account " 'a *pro rata* portion of any possible Section 16(b) claim' ") (quoting from proxy statement).

purchases of stock—the issuer, or its new parent, will often have no reason to avoid bringing a Section 16(b) action against the former ten percent shareholder.[16] *See Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 415 (D. Md.) ("Most of the section 16(b) violation cases involving hostile takeover situations, were brought by or on behalf of the successor by merger to the original issuer."), *appeal dismissed*, 801 F.2d 393 (4th Cir. 1986). Indeed, this Court's decisions in *Kern County Land Co.* and *Reliance Elec.* both involved suits by post-takeover issuers (*not* security holders) against former ten percent beneficial owners who had made failed takeover attempts.

In the unlikely situation in which a publicly held corporation is merged with another entity for the sole purpose of depriving a security holder of standing to maintain a Section 16(b) action, the plaintiff may prevent the merger, and preserve his standing, by seeking to have the merger enjoined or annulled, *see, e.g., Heit v. Tenneco, Inc.*, 319 F. Supp. 884, 885-86 (D. Del. 1970) (plaintiff lost standing to maintain derivative suit after merger; appropriate remedy was to apply for an injunction prior to merger), or pursue an action against the corporation's directors for breach of fiduciary duty, *see, e.g., Merritt v. Colonial Foods, Inc.*, 505 A.2d 757 (Del. Ch. 1986) (cash-out merger for purpose of terminating plaintiffs' standing to maintain pending derivative litigation against corporate insiders constituted breach of fiduciary duty of directors and controlling shareholders); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) (if new ultimate parent company of issuer, CSX, were improperly

16 Any agreement that the former "insiders" might have negotiated prior to the acquisition obligating the issuer or its new owner not to bring a Section 16(b) action would be unenforceable under Exchange Act § 29(a), 15 U.S.C. § 78cc(a), which renders void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Exchange Act] or of any rule or regulation thereunder." *See, e.g., Allied Artists Pictures Corp. v. Giroux*, 312 F. Supp. 450, 451 (S.D.N.Y. 1970); *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 418-19 (D. Md.), *appeal dismissed*, 801 F.2d 393 (4th Cir. 1986).

deterred from bringing Section 16(b) action, shareholders of CSX "are not without a remedy. They could bring a derivative suit against the directors and officers of CSX for breach of fiduciary duty . . . ."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988).

Moreover, in those cases where actual abuse of inside information can be shown—and there has been no allegation by Respondent or any indication in the record that this occurred here—the securities laws provide other sanctions. In this regard, this Court's reasoning in *Foremost-McKesson, supra*, where the Court held that a defendant must be a ten percent beneficial owner before purchases and sales of securities would be subject to Section 16(b) (thus excluding the transaction that causes the defendant to exceed the ten percent threshold), is particularly appropriate:

> Congress . . . has left some problems of the abuse of inside information to other remedies. These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information in transactions not covered by § 16(b).

423 U.S. at 255. The Court in *Foremost-McKesson* then cited Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, as examples of provisions that afforded the Commission and injured investors a remedy for abuse of inside information. 423 U.S. at 255. Since *Foremost-McKesson* was decided in 1976, Congress has further added to the arsenal of remedies available against abuse of inside information with the Insider Trading Sanctions Act of 1984, Exchange Act § 21A, 15 U.S.C. § 78u-1, which permits the Commission to seek a penalty against insider trading of up to three times the profits gained, and the Insider Trading and Securities Fraud Enforcement Act of 1988, Exchange Act § 20A, 15 U.S.C. § 78t-1, which provides a private right of action for insider trading to anyone who purchases or sells securities contemporaneously with

the alleged violation. Thus, the reasoning of this Court in *Foremost-McKesson* applies even more strongly today, and the Court of Appeals' expansion of the standing requirements of Section 16(b) is particularly inappropriate in light of that reasoning.

E. This Case Is Not Properly Distinguishable From Other Section 16(b) Standing Cases

Despite the efforts of the majority below to avoid a conflict with prior decisions by seeking to distinguish those decisions factually, its ruling that "owner of any security of the issuer" also means "former" owner of any security of the issuer is squarely at odds with rulings of the Seventh and Ninth Circuits—the only other Courts of Appeals that have addressed the issue—as well as with prior case law of the Second Circuit itself. These prior decisions confirmed that the plain meaning of "owner of any security of the issuer"—as set forth in Part B, *supra*—confers standing only on one who continues to be an owner of the issuer's securities throughout the lawsuit.

In *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979), a case that is virtually indistinguishable from the instant case, the plaintiff commenced a Section 16(b) action to recover profits from short-swing trading in shares of KBI. At the time the action was commenced, the plaintiff was a shareholder in KBI as well as another corporation (Cabot). Five days after the commencement of the action, KBI entered into a merger transaction in which shareholders of KBI were cashed out and as a result of which KBI became the wholly owned subsidiary of CSMC, which in turn was a subsidiary of Cabot. The plaintiff then amended his complaint to assert that he was maintaining it on behalf of Cabot as well as KBI.

The Seventh Circuit was faced with two questions: Was the plaintiff still an "owner of any security of the issuer" (KBI) within the meaning of Section 16(b)? And did the plaintiff's status as a shareholder of Cabot give him standing under Sec-

tion 16(b)? The court answered both questions in the negative.

As for the plaintiff's status as an "owner of any security of the issuer," the court ruled that once the plaintiff lost his shares of KBI, he lost his standing to sue on its behalf under Section 16(b). *Portnoy*, 607 F.2d at 767 (citing *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977)).

On the second question, whether owning a security of the grandparent of the issuer was sufficient to confer Section 16(b) standing, the court noted that the policy grounds urged to permit such standing did not permit it to "rewrite the statute to accommodate this situation [since] Congress has spoken clearly." 607 F.2d at 768. The court noted that, as is true in this proceeding, the issuer still existed and its sole shareholder (there CSMC, here Viacom) "had the right to bring the action regardless of whether it chose to exercise that right." *Id.* at 769. In a passage that could easily have been directed at the reasoning of the Court of Appeals below, the Seventh Circuit further noted that "[i]t would be a dangerous precedent to confer standing on a plaintiff who falls outside the class of parties permitted by the language of the statute to bring suit merely because the only parties that fall within the class choose not to exercise their right to sue."[17] *Id.* Accordingly, the court ruled that the plaintiff lacked standing.

17 The court also noted that, although the result in *Portnoy* may appear to be "a harsh one in that a possible violation will apparently go uncorrected, we note on the more positive side that the plaintiff has not argued that the merger which cut off his standing . . . was accomplished for the fraudulent purpose of avoiding enforcement of the § 16(b) claim." *Id.* Similarly, as discussed in Part D, *supra*, Respondent has never contended in this case that the acquisition of International by Viacom was undertaken for the purpose of avoiding enforcement of Section 16(b), and the record amply demonstrates that the merger was unrelated to this lawsuit.

The Ninth Circuit, in a decision by a panel that included Justice (then Judge) Kennedy, reached a similar result in *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam). There, Coldwell Banker was acquired by Sears through a wholly owned subsidiary of Sears, SDC. Thereafter Coldwell Banker ceased to exist as a separate corporate entity. The plaintiff who commenced this Section 16(b) action was a shareholder of Sears, and had never owned stock of Coldwell Banker or SDC. He sought the recovery of short-swing profits made by a director of Coldwell Banker through the director's sale of his Coldwell Banker shares.

In determining whether the plaintiff had standing, the *Lewis* court concluded that the answer was readily ascertained from the language of the statute:

> Section 16(b) permits a security holder of the issuer to bring a section 16(b) action only after the issuer has failed either to institute an action or to prosecute diligently after instituting an action. We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute. We will not confer standing on a plaintiff who falls outside the class of persons permitted by the language of the statute to bring suit merely because the only parties falling within the class choose not to exercise their right to sue. *Portnoy*, 607 F.2d at 769.
>
> Congress is well aware of the corporate practice of parent companies utilizing wholly owned subsidiaries in merger transactions. Had Congress wanted to discourage this practice by conferring standing on shareholders of a parent corporation whose wholly owned subsidiary absorbed the original issuing corporation, it knew how to do so.

762 F.2d at 804. Accordingly, the *Lewis* court concluded that the plaintiff lacked standing. *See also Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation.") (citing *Portnoy, supra*, and *Rothenberg, supra*), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982).

Prior to the holding of the Court of Appeals below, it had also been the law in the Second Circuit that a plaintiff security holder who commenced a Section 16(b) suit on behalf of an issuer had to own and continue to own his securities of the issuer throughout the litigation, and that if such a plaintiff ceased to own such securities—for any reason—he was denied standing to continue the action.[18] For example, in

---

18 The only exception to this rule was the district court decision in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966). In *Blau*, the court held that a shareholder of American Can Company could bring a Section 16(b) suit against a former director of a company which had sold all its assets to a subsidiary of American Can and thereafter ceased to exist. In sustaining the plaintiff's standing in *Blau*, the court noted that the original issuer had ceased to exist as a corporate entity after the transaction and thus it no longer had any shareholders who could sue. It concluded that to limit standing to the former shareholders of the now defunct issuer would mean that no one could possibly bring a Section 16(b) suit against the company's former directors. In so holding, the court, like the majority below, relied almost exclusively on the perceived policy behind the statute, virtually ignoring the language. *Id.* at 887 ("In sum, the essential argument which the defendant advances is one of language. But language alone can never be dispositive of a statute's meaning."). Other courts have criticized *Blau's* reasoning. *See, e.g., Portnoy*, 607 F.2d at 769 n.8; *Lewis*, 762 F.2d at 803-04; dissenting opinion below, 909 F.2d at 734; 24a-26a. *Blau* is inapplicable to the instant case in any event because the issuer, International, survived the merger and remains a viable corporation as a wholly owned subsidiary of Viacom.

Prior to the decision below, *Blau* had been distinguished in the Second Circuit on the ground that the issuer in that case was no longer a viable corporate entity. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). Although the majority below referred repeatedly to *Blau* with

Rothenberg v. United Brands Co., [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the district court held, and the Second Circuit affirmed, that a shareholder who had commenced a Section 16(b) suit lost his standing to continue that suit when he ceased to be a shareholder of the issuer as a result of a "short form" merger (in which public shareholders, including the plaintiff, had no vote) following a tender offer that the plaintiff had refused to accept.[19]

Finally, in *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988), the issuer (Sea-Land) was merged with another corporate entity such that Sea-Land survived and became the wholly owned subsidiary of CSX. In dismissing the plaintiff's Section 16(b) action—on the ground that the plaintiff, an owner of CSX stock, lacked standing because he was not the owner of any security in the issuer, Sea-Land—the district court identified the only parties that would have standing to pursue such an action: the issuer (Sea-Land) or its sole shareholder (CSX). In affirming the district court's decision, the Second Circuit also identified these parties as the only entities that would be entitled to maintain a Section 16(b) action.

approval, the majority's "rule"—extending standing only to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer," 909 F.2d at 730-31; 16a-17a—is actually inconsistent with *Blau*, where the plaintiff had never owned a security of the issuer.

19 The majority below "caution[ed] against an overbroad application of *Rothenberg*" in part on the ground that its "standing analysis was premised on an analogous application of Rule 23.1 which . . . does not govern shareholders bringing § 16(b) claims." 909 F.2d at 730; 16a. However, the *Rothenberg* court was well aware of the distinctions between Section16(b) claims and Rule 23.1, *see Rothenberg* at 91,692, and the majority's opinion below even cited *Rothenberg* in a discussion of the distinctions between Section16(b) claims and Rule 23.1. 909 F.2d at 728; 11a.

Neither court included in the list "former" shareholders of Sea-Land.

The decision of the Court of Appeals below thus plainly stands out in stark contrast to this well-established line of decisions of the Second, Seventh and Ninth Circuits in its willingness to expand the standing provisions of Section 16(b). Indeed, even the Commission, which filed an *amicus* brief in the Court of Appeals below in support of Respondent, has recognized—in releases issued in connection with the proposal of the recently adopted rule changes under Section 16—that it was settled law prior to the Court of Appeals' decision in this case that Section 16(b) plaintiffs must hold their securities of the issuer throughout the course of the litigation. *See, e.g.*, Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620-21, 42 SEC Docket 464, 490 (Dec. 2, 1988).

In an effort to characterize its decision as not conflicting with these established precedents from its own and other circuits, the majority below identified certain distinctions that purport to set the instant action apart from decisions discussed above.

The sole distinction the majority found in this proceeding from *Portnoy* and *Rothenberg* is that in those cases, the holders of the issuer's securities received only cash for their securities whereas in the instant action, Respondent received cash *and* some stock in the acquiror. The majority maintained that here, unlike in *Portnoy* and *Rothenberg*, Respondent—by virtue of receiving stock in the acquiror—"continues to have at least an indirect financial interest in the outcome of this lawsuit." 909 F.2d at 730; 16a. As for *Lewis* and *Untermeyer*, the majority noted as the sole distinction the fact that in those actions, the plaintiff never held stock in the issuer, but only in the parent corporation. *Id.* at 730; 15a-16a. These distinctions, however, lack substance.

As an initial matter, the majority did not explain why the statutory analysis followed in these cases is not applicable to this proceeding. As set forth above, the Seventh and Ninth Circuit Courts of Appeals have found the language of Section 16(b) at issue to be plain and unambiguous. As noted in Part B, *supra*, statutory language, if clear and unambiguous, will ordinarily be regarded as conclusive, "since it is generally assumed that Congress expresses its purpose through the ordinary meaning of the words it uses." *Lewis, supra*, 762 F.2d at 804 (citing *Escondido Mut. Water Co. v. La Jolla Band of Missions Indians*, 466 U.S. 765, 772 (1984); *North Dakota v. United States*, 460 U.S. 300, 312 (1983); *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Similarly, the Court of Appeals failed to address the rejection in these prior decisions of the same "policy arguments" that appear to be the sole foundation for the result reached below.

More importantly, the distinctions drawn by the majority prove to be meaningless. First, the majority does not appear to disagree with the general rule that one who owns securities *only* in the parent of the issuer does not have standing under Section 16(b). *See* 909 F.2d at 730; 15a-16a (discussing *Untermeyer* and *Lewis*). The majority opinion, however, seeks to create an exception to this rule for a plaintiff whose securities of the issuer were exchanged for securities in the parent corporation in a merger transaction, thus giving the plaintiff "a continuing interest in maintaining suit in behalf of the issuer." *Id.* at 731; 16a-17a.

The majority's purported distinction wholly fails to explain the opposite result that was reached in *Portnoy*. The plaintiff in *Portnoy* owned securities of the grandparent corporation of the issuer at the time of the merger, and therefore had a "continuing financial interest in the litigation" in every sense that Respondent did here. The majority's implied distinction on the ground that Respondent received his shares in the issuer's parent *in exchange for* his shares of the issuer, while in *Portnoy* the plaintiff's ownership of shares in the issuer's grandparent was independent of the merger, is irrelevant both

to the statutory language and to the majority's perception of the statutory design.

There is no support in the language of the statute, the legislative history or prior case law for distinguishing between a plaintiff who received securities of a parent *directly* in exchange for his securities in the issuer and one who received cash for his securities but already owned securities of the parent (as in *Portnoy*) or one who timely purchased securities of the parent thereafter (as in *Rothenberg*).[20]

Accordingly, there can be no meaningful distinction drawn between this case and the prior decisions of the other Courts of Appeals that have addressed this question, as well as prior decisions of the Second Circuit. Like the plaintiffs in *Portnoy* and *Rothenberg*, when Respondent lost his ownership interest in the issuer, he lost his standing to continue this action. Like the plaintiffs in *Portnoy*, *Lewis* and *Untermeyer*, the Respondent's ownership of securities of a parent of the issuer does not confer standing under the plain terms of the statute.

Therefore, the majority's holding that a shareholder of the issuer who loses that security and instead acquires a security of the parent corporation nevertheless continues to have standing, is inexorably in conflict with the plain language of Section 16(b) and the decisions of every other court that has addressed the issue (including the Second Circuit itself).

---

20 In *Rothenberg*, after being cashed out, the plaintiff purchased a security in the ultimate parent of the issuer in an effort to regain standing. The court did not decide whether this revitalized the plaintiff's standing because no demand had been made on the ultimate parent entity. *Id.* at 91,692-93.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed, and the case should be remanded to the Court of Appeals with directions to affirm the order appealed from.

Dated: February 13, 1991

Respectfully submitted,

Edwin B. Mishkin
(*Counsel of Record*)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners

(4)

No. 90-659

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT APPENDIX

Edwin B. Mishkin
(*Counsel of Record*)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000
Attorneys for Petitioners

Irving Malchman
(*Counsel of Record*)
KAUFMAN MALCHMAN KAUFMANN & KIRBY
919 Third Avenue
New York, New York 10022
(212) 371-6600
Attorneys for Respondent Ira L. Mendell

Norman C. Kleinberg
(*Counsel of Record*)
HUGHES HUBBARD & REED
One Battery Park Plaza
New York, New York 10004
(212) 837-6000
Attorneys for Respondents Viacom Inc. and Viacom International Inc.

PETITION FOR CERTIORARI FILED OCTOBER 23, 1990
CERTIORARI GRANTED JANUARY 7, 1991

4/7

TABLE OF CONTENTS

The following items have been omitted in printing this Joint Appendix because they appear on the following pages in the Appendices to the Petition for a Writ of Certiorari:

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

District Court

1-6-87 Fld. Complaint; Issd. Summons & Notice purs. to 28 U.S.C. 636(c). Jury Trial Demanded.

2-24-87 Fld. ANSWER of defts. other than Viacom International Inc. to the complt.

3-6-87 Fld. ANSWER of deft. Viacom International Inc. to the complt.

10-16-87 Fld. Pltff. IRA L. MENDELL'S Motion for Leave to File Proposed AMENDED COMPLAINT, for an Order pursuant to Rule 15(a) of the FRPC [sic] granting leave to pltff to file the annexed complaint, and for such other and further relief as this Court may deem just and proper.

10-16-87 Fld. Memorandum In Support of Pltff's Motion For Leave to File AMENDED COMPLAINT.

11-10-87 Fld. Memo Endorsed on letter dated November 4, 1987 to Judge Leisure, for an adjournment of the proceedings relating to pltff's motion to amend the complaint, now pending before your Honor, until March 1, 1988 in the expectation that the Court of Appeals will have decided the appeal un [sic] Untermeyer by the date . . . SO ORDERED, LEISURE, J.

2-29-88 STIPULATION, defts consents [sic] to pltffs proposed amended complt . . . pltff will serve & file amended complt. by 3/15/88 . . . Mukasey, J.

3-8-88 Fld. Scheduling Order, if 2nd circuit does not decide or deny application for rehearing en bac [sic] in Untermeyer V. Valhi by 4/15/88 defts to serve summary judgment motion by 4/29/88 . . answers 5/20/88 . . . reply served by 6/3/88 . . If the 2nd circuit grants application this schedule will be suspended . . . Mukasey, J.

3-15-88	Fld. Pltffs AMENDED COMPLT. Jury Trial Demanded.
4-12-88	Fld. STIPULATION, the defts other than Viacom Internaitonal [sic] & Viacom Inc., will serve motion for dismissal & for summary judgment with respect to the Amended complt by 5/30/88 . . answer or opposition papers of pltff shall be served by 6/20/88 . . reply of defts served by 7/1/88 . . . Mukasey, J.
5-27-88	Fld. Defts other than Viacom International Inc., & Viacom's MEMO OF LAW in support of defts motion for summary judgment.
5-27-88	Fld. Defts other than Viacom International Inc. & Viacom's NOTICE OF MOTION for an order for summary judgment dismissing pltffs amended complt. RET: 7/5/88.
6-23-88	Fld. Pltffs MEMO in opposition to defts motion for summary judgment.
6-23-88	Fld. Pltffs AFFIDAVIT & Accompanying rule 3g Statement.
7-5-88	Fld. Defts other than Viacom International & Viacom Inc's Statement purs to rule 3g.
11-9-88	Fld. OPINION & ORDER # 63376, Summary judgment for defts disposes entirely of pltffs claims and requires dismissal of this action as to International & Viacom . . . . Mukasey, J.
12-6-88	Fld. Pltffs NOTICE OF APPEAL from the order dated 11/8/88 granting defts motion for summ judgment dismissing the complt.
1-17-89	Fld. JUDGMENT, ordered that complt. be dismissed . . . RFB, Clerk. EOD 1/18/89.
3-2-89	Fld. Pltffs NOTICE OF MOTION for an order relieving pltff of the order of the court dated 11/8/88 and the judgment of the court dated 1/17/89, granting defts motion for summ. judmgent [sic] and dismissal of the complt. RET: 4/7/89.

3-2-89	Fld. Pltffs MEMO in support of pltffs motion for an order relieving pltffs of courts order and judgment of dismissal.
3-24-89	Fld. deft's AFFDVT of EDWIN B. MISHKIN.
3-24-89	Fld. deft's MEMO of LAW in opp. to ptlf's [sic] motion to vacate Ct.'s order & judgt.
4-4-89	Fld. Pltffs REPLY Affidavit of I. Malchman in support of the instant motion by pltff in re to order dtd 1/17/89.
4-4-89	Fld. Pltffs REPLY MEMO in support of pltffs motion for an order relieving pltffs court order and judgment of dismissal. (oral argument requested)
4-12-89	Fld. Sur Reply MEMO OF LAW in opposition to pltffs motion to vacate this courts order and judgment of dismissal.
5-24-89	Fld. OPINION & ORDER # 64338 . . . Mendell has failed to meet the applicable legal standards for vacating the earlier order dismissing his claim. Accordingly, his motion for relief from that order and the judgment dismissing his action is denied . . . Mukasey, J.
6-20-89	Fld. Pltffs NOTICE OF APPEAL to the USCA 2nd circuit from the order dated 5/23/89.

Court of Appeals

8-11-89	ORDER Consolidating Appeals 89-7068 and 89-7686 filed (Clerk)
11-21-89	Case heard before OAKES, CH.J., CARDAMONE, C.JJ., POLLACK, D.J.
1-10-90	Amicus Curiae SEC brief filed w/pfs (to panel)
7-25-90	Judgment AFFIRMED, REVERSED and REMANDED by published signed opinion *FILED* (RJC)

7-25-90	Judge POLLACK dissenting in separate opinion
7-25-90	Judgment FILED
8-16-90	Mandate (judgment & opinion) issued.
10-26-90	Notice of filing of petition for writ of certiorari filed. SC:90-659

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of VIACOM INTERNATIONAL, INC. and VIACOM INC.

Plaintiff,

—against—

KEITH R. GOLLUST, *et al.*

Defendants.

NOTICE OF MOTION

PLEASE TAKE NOTICE that, upon the accompanying Memorandum of Law and Affidavit of Edwin B. Mishkin, defendants herein other than Viacom International, Inc. and Viacam, [sic] Inc., by their undersigned attorneys, will move this Court before the Hon. Michael B. Mukasey, United States Courthouse, Foley Square, New York, New York, in Room 615, on July 5, 1988, or as soon thereafter as counsel may be heard, for an order pursuant to Fed. R. Civ. P. 56 for summary judgment dismissing plaintiff's amended complaint, and for such other and further relief as may be just and proper;

PLEASE TAKE FURTHER NOTICE that, pursuant to a Stipulation between the undersigned counsel and counsel for the plaintiff, any answering or opposition papers of plaintiff shall be served no later than June 20, 1988, and that any reply papers of the moving defendants shall be served no later than July 1, 1988.

Dated: New York, New York
May 27, 1988

CLEARY, GOTTLIEB, STEEN & HAMILTON

By /s/ EDWIN B. MISHKIN
A Member of the Firm
One State Street Plaza
New York, New York 10004
(212) 344-0600

Attorneys for Defendants other than Viacom International, Inc. and Viacom Inc.

TO:

KAUFMAN MALCHMAN KAUFMANN & KIRBY
919 Third Avenue
New York, New York 10022
(212) 371-6600

Attorneys for Plaintiff Ira L. Mendell

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of VIACOM INTERNATIONAL, INC. and VIACOM INC.

Plaintiff,

—against—

KEITH R. GOLLUST, *et al.*

Defendants.

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

AFFIDAVIT OF EDWIN B. MISHKIN

EDWIN B. MISHKIN, being duly sworn, deposes and says:

1. I am a member of the bar of the State of New York and the bar of this Court and am a member of the law firm of Cleary, Gottlieb, Steen & Hamilton, attorneys for defendants herein other than Viacom International, Inc. ("Viacom") and Viacam, [sic] Inc. ("VI"). I submit this affidavit and the exhibits hereto in support of the Motion for Summary Judgment of defendants herein other than Viacom and VI.

2. Attached hereto as Exhibit 1 are true and correct copies of a Letter to Shareholders of Viacom dated May 4, 1987, a Notice to Shareholders of Viacom dated May 4, 1987, and the Proxy Statement of Viacom/Prospectus of VI dated May 4, 1984 (the "Proxy Statement") and, annexed to the Proxy

Statement as Annex A, an Agreement of Merger dated March 3, 1987.

3. Attached hereto as Exhibit 2 is a certified copy of a Certificate of Merger of Arsenal Acquiring Corp. ("Arsenal") into Viacom, filed with the Secretary of State of the State of Delaware on June 8, 1988.

4. Attached hereto as Exhibit 3 is a certified copy of a Certificate of Merger of Arsenal into Viacom, filed with the Secretary of State of the State of Ohio on June 9, 1987.

Dated: New York, New York
May 27, 1988

/s/ EDWIN B. MISHKIN
Edwin B. Mishkin

Sworn to before me this
27th day of May, 1988

(Remainder of jurat omitted in printing)

[Exhibit 1 to Mishkin Affidavit]

(Logo omitted in printing)

VIACOM INTERNATIONAL INC.
1211 Avenue of the Americas
New York, New York 10036

May 4, 1987

Dear Shareholder:

You are cordially invited to attend a Special Meeting of Shareholders of Viacom International Inc. (the "Company") to be held on Wednesday, June 3, 1987, at 9:00 A.M., local time, at the Viacom Conference Center, 140 West 43rd Street, New York, New York. At this important meeting you will be asked to consider and vote upon the proposed merger of Arsenal Acquiring Corp. ("Acquisition"), a wholly owned subsidiary of Viacom Inc. (formerly known as Arsenal Holdings, Inc.) ("Holdings"), with and into the Company (the "Merger"), pursuant to an Agreement of Merger, dated as of March 3, 1987 (the "Merger Agreement"), by and among Holdings, Acquisition and the Company. Holdings is a wholly owned subsidiary of National Amusements, Inc., a Maryland corporation ("National Amusements"), all of the voting stock of which is controlled by Sumner M. Redstone.

The Merger Agreement provides that each share of Common Stock, par value $1.00 per share, of the Company (the "Company Common Stock") owned by the shareholders of the Company (other than dissenting shares and shares held by the Company, Holdings, Acquisition or any other subsidiary of Holdings) immediately prior to the consummation of the Merger will be converted into (i) the right to receive $42.75 in cash plus an interest factor in an amount equal to simple interest on such cash amount from May 1, 1987 through the effective time of the Merger (the "Effective Time") at an annual rate of 9% from May 1, 1987 through May 31, 1987 and 12% thereafter, (ii) 0.30097 of a share of Cumulative Exchangeable Redeemable Preferred Stock, par value $0.01

per share, of Holdings (the "Exchangeable Preferred Stock") accruing dividends from May 1, 1987 and (iii) 0.20 of a share of Common Stock, par value $0.01 per share, of Holdings (the "Holdings Common Stock") (collectively, the "Merger Consideration"), all as more fully described in the accompanying Proxy Statement/Prospectus. The fraction of a share of Exchangeable Preferred Stock included as part of such Merger Consideration was chosen following a negotiation contemplated by the Merger Agreement between the financial advisor to the Special Committee of the Company's Board of Directors and the financial advisor to Holdings as to the fraction which on April 30, 1987 would have an expected market value on a fully distributed basis of approximately $7.75 (excluding the value of dividends accruing from May 1, 1987 to the Effective Time). Since it is likely that general market conditions and possible that the Company's business circumstances will be different when the Exchangeable Preferred Stock actually trades (either initially or subsequently on a fully distributed basis), *there can be no assurance that the actual market value of such fraction of a share of Exchangeable Preferred Stock following the Effective Time (excluding accrued dividends) will not be less than $7.75.*

The Exchangeable Preferred Stock will have a liquidation preference of $25 per share, and will bear cumulative quarterly dividends at the annual rate of 15.5%, payable in cash when, as and if declared out of funds legally available therefor or, through the first dividend payment date following the sixth anniversary of the Effective Time, at Holdings' option, in additional shares of Exchangeable Preferred Stock in lieu of cash, at the rate of 0.04 of a share of Exchangeable Preferred Stock for each $1.00 of such dividends not paid in cash. Dividends on the Exchangeable Preferred Stock shall accrue from May 1, 1987. The declaration and payment of cash dividends on the Exchangeable Preferred Stock is expected to be effectively prohibited for the first six years following the Effective Time, and to be significantly restricted thereafter, as a result of the terms of financing agreements to be entered into by Acquisition in connection

with the Merger; accordingly, it is expected that dividends on the Exchangeable Preferred Stock will be paid in additional shares of Exchangeable Preferred Stock in lieu of cash for the first six years following the Effective Time. The Exchangeable Preferred Stock will be exchangeable, at any time at Holdings' option, for Junior Subordinated Exchange Debentures of Holdings (the "Exchange Debentures").

As a result of the Merger, the outstanding shares of Company Common Stock will be cancelled, and the Company will become a wholly owned subsidiary of Holdings. The shares of Holdings Common Stock issued as part of the Merger Consideration will, in the aggregate, represent approximately 17.4% of the Holdings Common Stock outstanding immediately following consummation of the Merger, assuming (i) the conversion and exercise prior to the Effective Time of all outstanding securities and warrants convertible into or exercisable for shares of Company Common Stock, (ii) the settlement of all outstanding options to purchase Company Common Stock for the Merger Consideration and (iii) the failure of any shareholders to perfect dissenters' rights ((i), (ii) and (iii) collectively being hereinafter referred to as "full participation in the Merger"). Assuming full participation in the Merger, National Amusements will own approximately 82.6% of the Holdings Common Stock. For a description of Holdings, Acquisition and National Amusements, see "CERTAIN INFORMATION REGARDING HOLDINGS, ACQUISITION AND NATIONAL AMUSEMENTS" in the accompanying Proxy Statement/Prospectus.

The consummation of the Merger is subject, among other things, to the receipt of certain regulatory approvals which may not be obtained prior to the date of the Special Meeting of Shareholders and to the availability of the necessary financing. See "RISK FACTORS", "THE MERGER AGREEMENT—Covenants and Conditions".

You are urged to read the accompanying Proxy Statement/Prospectus, which provides you with a detailed description of the terms of the proposed Merger as well as of the Exchangeable Preferred Stock, the Exchange Debentures and the Hold-

ings Common Stock. *A continuing investment in Holdings following the Merger involves a high degree of risk.* You are urged to read the "RISK FACTORS" section of the accompanying Proxy Statement/Prospectus for a description of such risks. A copy of the Merger Agreement is attached as Annex A to the Proxy Statement/Prospectus. Please give this information your careful attention.

A Special Committee appointed by the Board of Directors of the Company, consisting of all the independent members of the Board (the "Special Committee"), has carefully reviewed and considered the terms and conditions of the proposed Merger. In connection with its review, the Special Committee retained Goldman, Sachs & Co. ("Goldman Sachs") to act as its financial advisor. Goldman Sachs have rendered an opinion that, based upon and subject to the matters contained in their opinion letter, as of the date hereof the Merger Consideration to be received by the holders of Company Common Stock (other than Holdings, Acquisition or any other subsidiary of Holdings) pursuant to the Merger Agreement is fair to such holders. The full text of the opinion of Goldman Sachs is attached to the Proxy Statement/Prospectus as Annex C, to which reference is made for a complete description of the procedures followed, assumptions made, areas of reliance upon others and the other matters considered by Goldman Sachs in arriving at their opinion. Shareholders are urged to read the full text of the Goldman Sachs opinion.

The Special Committee has unanimously determined that the terms of the Merger are fair to, and in the best interests of, the shareholders of the Company (other than National Amusements) and has unanimously recommended that the Board of Directors of the Company approve the Merger Agreement. The Board of Directors has approved the Merger Agreement and recommends that shareholders of the Company vote FOR approval of the Merger Agreement. For a further discussion of the factors considered by the Special Committee during the course of its evaluation of the Merger, see "BACKGROUND OF THE MERGER AND RELATED

MATTERS—Recommendations of the Company's Special Committee and Board of Directors; Reasons for the Merger" in the accompanying Proxy Statement/Prospectus.

Shareholders of the Company who do not vote in favor of the Merger and who comply with the requirements of Section 1701.85 of the Ohio General Corporation Law will have the right, if the Merger is consummated, to seek appraisal of their shares of Company Common Stock. See "RIGHTS OF DISSENTING SHAREHOLDERS" in the accompanying Proxy Statement/Prospectus, and Annex D thereto, for a description of the procedures required to be followed in order to perfect dissenters' rights.

The Merger cannot be effected unless it is approved by the holders of at least a majority of all outstanding shares of Company Common Stock entitled to vote at the Special Meeting. *Accordingly, your vote is important, no matter how large or small your holdings may be.*

Whether or not you are personally able to attend the Special Meeting, please complete, sign, date and return the enclosed proxy as soon as possible. You may, of course, attend the Special Meeting and vote in person even if you have previously returned your proxy.

Sincerely,

/s/ Terrence A. Elkes

TERRENCE A. ELKES
President and Chief Executive Officer

* * * *

PROXY STATEMENT/PROSPECTUS

PROXY STATEMENT

VIACOM INTERNATIONAL INC.
1211 Avenue of the Americas
New York, New York 10036
(212) 575-5175

PROSPECTUS

VIACOM INC.

Common Stock
Cumulative Exchangeable Redeemable Preferred Stock
Junior Subordinated Exchange Debentures Due 2006

SPECIAL MEETING OF SHAREHOLDERS

To Be Held on June 3, 1987

This Proxy Statement/Prospectus is being furnished to shareholders of Viacom International Inc., an Ohio corporation (the "Company"), in connection with the proposed merger (the "Merger") of Arsenal Acquiring Corp., a Delaware corporation ("Acquisition") and a wholly owned subsidiary of Viacom Inc., a Delaware corporation (formerly known as Arsenal Holdings, Inc.) ("Holdings"), with and into the Company, pursuant to an Agreement of Merger, dated as of March 3, 1987 (the "Merger Agreement"), by and among Holdings, Acquisition and the Company. As a result of the Merger, the Company would become a wholly owned subsidiary of Holdings, and the shareholders of the Company (other than Holdings, Acquisition or any other subsidiary of Holdings) would receive cash and shares of common and preferred stock of Holdings. Holdings and Acquisition are newly-

formed corporations organized in connection with the transactions contemplated by the Merger Agreement. Holdings is a wholly owned subsidiary of National Amusements, Inc., a Maryland corporation ("National Amusements"), all of the voting stock of which is controlled by Sumner M. Redstone. National Amusements and its affiliates owned, as of the record date, 6,972,400 shares of Common Stock, par value $1.00 per share, of the Company (the "Company Common Stock"), constituting approximately 19.0% of the shares of Company Common Stock outstanding on such date, all of which will be voted in favor of the Merger.

As a result of the Merger, each outstanding share of Company Common Stock, other than any shares owned by Holdings (which will hold not less than 6,881,800 shares of Company Common Stock at the Effective Time pursuant to a capital contribution to it by National Amusements), Acquisition or any other subsidiary of Holdings, shares held in the treasury of the Company and shares in respect of which dissenters' rights are perfected under the Ohio General Corporation Law, would be converted into (i) the right to receive $42.75 in cash, plus an interest factor in an amount equal to simple interest on such cash amount from May 1, 1987 through the effective time of the Merger (the "Effective Time") at an annual rate of 9% from May 1 through May 31, 1987 and 12% thereafter (the "Interest Factor"), (ii) 0.30097 of a share of Cumulative Exchangeable Redeemable Preferred Stock, par value $0.01 per share, of Holdings (the "Exchangeable Preferred Stock"), accruing dividends from May 1, 1987 and (iii) 0.20 of a share of Common Stock, par value $0.01 per share, of Holdings (the "Holdings Common Stock"), all as more fully described herein. The cash (including the additional cash to be paid as a result of the Interest Factor) and shares of Exchangeable Preferred Stock and Holdings Common Stock payable to shareholders for their shares of Company Common Stock are hereinafter referred to as the "Merger Consideration". The Exchangeable Preferred Stock will be exchangeable, at any time at Holdings' option, for Junior Subordinated Exchange Debentures of

Holdings (the "Exchange Debentures"). The Exchangeable Preferred Stock and the Exchange Debentures, if issued, will be subject to optional redemption by Holdings at any time at their respective liquidation preference and principal amount plus all accrued but unpaid dividends or interest, as the case may be.

Following the Effective Time, Holdings will be a public company and, assuming (i) the conversion and exercise prior to the Effective Time of all outstanding securities and warrants convertible into or exercisable for shares of Company Common Stock, (ii) the settlement of all outstanding options to acquire shares of Company Common Stock ("Company Options") for the Merger Consideration and (iii) the failure of any shareholders to perfect dissenters' rights ((i), (ii) and (iii) collectively being hereinafter referred to as "full participation in the Merger"), will have approximately 53.3 million shares of Holdings Common Stock and approximately 13.99 million shares of Exchangeable Preferred Stock outstanding.

The Company's securityholders who become entitled to receive Merger Consideration will own approximately 17.4% of the Holdings Common Stock outstanding immediately following the Effective Time and National Amusements will own approximately 82.6% of such stock, in each case assuming full participation in the Merger. *Immediately following the Merger, National Amusements will therefore be in a position to elect all the directors of Holdings and to control its business policies.* For a description of the expected equity and voting interest in Holdings, see "OWNERSHIP OF COMPANY AND HOLDINGS CAPITAL STOCK—Holdings Capital Stock". For a description of Holdings and National Amusements, see "CERTAIN INFORMATION REGARDING HOLDINGS, ACQUISITION AND NATIONAL AMUSEMENTS".

The consummation of the Merger is subject, among other things, to the receipt of certain regulatory approvals which may not be obtained prior to the date of the Special Meeting of Shareholders and to the availability of the necessary financing. See "RISK FACTORS" and "THE MERGER AGREEMENT—Covenants and Conditions".

There are significant risks associated with the Merger and with an investment in the Exchangeable Preferred Stock, the Holdings Common Stock and, if issued, the Exchange Debentures. For a description of the terms of such securities, as well as such risks and certain significant financial considerations associated therewith, see "RISK FACTORS", "CERTAIN FEDERAL INCOME TAX CONSEQUENCES" and "DESCRIPTION OF HOLDINGS' CAPITAL STOCK".

THIS PROXY STATEMENT, WHICH IS BEING FURNISHED TO THE COMPANY'S SHAREHOLDERS FOR PURPOSES OF VOTING UPON THE AFOREMENTIONED MERGER AGREEMENT, ALSO CONSTITUTES THE PROSPECTUS OF HOLDINGS FOR THE RELATED ISSUANCE OF THE EXCHANGEABLE PREFERRED STOCK, THE HOLDINGS COMMON STOCK AND, IF AND WHEN ISSUED, THE EXCHANGE DEBENTURES. This Proxy Statement/Prospectus also relates to and covers the resale of shares of Holdings Common Stock and shares of Exchangeable Preferred Stock issuable to certain officers of the Company. See "MANAGEMENT OF THE COMPANY—Executive Officers".

The Merger Agreement and the transactions contemplated thereby involve matters of great importance to the shareholders of the Company. If the proposal to adopt the Merger Agreement is approved and the Merger is consummated, the public shareholders of the Company will no longer own any of the Company Common Stock, but instead will receive $42.75 in cash (plus the additional cash payable as a result of the Interest Factor) and Exchangeable Preferred Stock and Holdings Common Stock, giving such shareholders a greatly reduced, indirect equity interest in the Company. Shareholders are urged to read and consider carefully the information contained in this Proxy Statement/Prospectus and to consult with their personal financial and tax advisors.

* * * *

The date of this Proxy Statement/Prospectus is May 4, 1987.

* * * *

SUMMARY OF PROXY STATEMENT/PROSPECTUS

* * * *

Purpose of the Special Meeting

At the Special Meeting, the holders of shares of Company Common Stock will be asked to consider and vote upon a proposal to adopt the Merger Agreement by and among Holdings, Acquisition and the Company. Holdings and Acquisition are newly-formed corporations organized in connection with the transactions contemplated by the Merger Agreement and are wholly owned subsidiaries of National Amusements. See "INTRODUCTION—The Special Meeting", "THE MERGER AGREEMENT" AND "CERTAIN INFORMATION REGARDING HOLDINGS, ACQUISITION AND NATIONAL AMUSEMENTS".

* * * *

Vote Required to Adopt the Merger Agreement

The affirmative vote of the holders of a majority of the outstanding shares of Company Common Stock entitled to vote at the Special Meeting is required to adopt the Merger Agreement. See "INTRODUCTION—Voting Rights and Proxy Information". As of the Record Date, National Amusements and its affiliates owned 6,972,400 shares of Company Common Stock, constituting approximately 19.0% of the shares outstanding on such date. National Amusements will, and its affiliates intend to, vote all such shares in favor of the Merger.

* * * *

Background of the Merger

On September 16, 1986, at a meeting of the Company's Board of Directors, MCV Holdings, Inc., a Delaware corporation ("MCV Holdings") organized by certain members of the Company's senior management (the "Management Group"), The First Boston Corporation ("First Boston"), Donaldson, Lufkin & Jenrette Securities Corporation

("DLJ"), Drexel Burnham Lambert Incorporated ("Drexel") and The Equitable Life Assurance Society of the United States ("ELAS") for the purpose of effecting a leveraged buyout of the Company, presented to the Board its proposal to acquire the Company in a leveraged buyout transaction (the "MCV Merger") in which shareholders of the Company would receive, for each share of Company Common Stock, $37.00 in cash and a fraction of a share of Exchangeable Preferred Stock of MCV Holdings (the "MCV Exchangeable Preferred Stock") designed to have an expected market value of $3.50 on a fully distributed basis (the "Initial MCV Proposal"). At that meeting, the Board of Directors of the Company established the Special Committee of the Board of Directors, consisting of its eight independent directors (the "Special Committee"), to review the Initial MCV Proposal.

The Special Committee retained a financial advisor, Goldman, Sachs & Co. ("Goldman Sachs"), and legal advisors and carefully reviewed and considered the Initial MCV Proposal with the assistance of such advisors. During the course of negotiations, MCV Holdings offered an increase in the aggregate consideration of the Initial MCV Proposal, on October 5, 1986 and again on October 6, 1986, to $35.00 in cash and a fraction of a share of MCV Exchangeable Preferred Stock designed to have an expected market value of $9.00 on a fully distributed basis (the "Modified MCV Proposal"). On October 6, 1986, the Special Committee rejected the Modified MCV Proposal as inadequate. On October 15, 1986, MCV Holdings presented to the Board of Directors another proposal to acquire the Company in an MCV Merger in which shareholders of the Company would receive (i) $37.00 in cash, (ii) a fraction of a share of MCV Exchangeable Preferred Stock to be chosen following a negotiation between Goldman Sachs and the financial advisors to MCV Holdings as to the fraction which would have an expected market value of $7.00 on a fully distributed basis and (iii) a fraction of a share of convertible preferred stock of MCV Holdings (the "MCV Convertible Preferred Stock") convertible, in the aggregate, into 10% of the common equity securi-

ties of MCV Holdings outstanding on a fully diluted basis immediately following consummation of an MCV Merger (the "Revised MCV Proposal").

As a result of continuing negotiations conducted on behalf of the Special Committee with MCV Holdings, the Revised MCV Proposal was subsequently modified on October 17, 1986 to provide that the Company's shareholders would receive (i) $37.00 in cash, (ii) such fraction of a share of MCV Exchangeable Preferred Stock as would, in the opinion of the respective financial advisors of MCV Holdings and the Company, have an expected market value of $7.00 on a fully distributed basis and (iii) a fraction of a share of MCV Convertible Preferred Stock convertible, in the aggregate, into 20% of the common equity securities of MCV Holdings outstanding on a fully diluted basis immediately following consummation of the MCV Merger (the "MCV Merger Consideration"). The Special Committee and the Board of Directors of the Company each unanimously determined that the terms of the Revised MCV Proposal, as modified, providing for the MCV Merger Consideration were fair to, and in the best interests of, the public shareholders of the Company, and, on October 17, 1986, the Company entered into a merger agreement (the "MCV Merger Agreement") with MCV Holdings reflecting the foregoing terms.

On February 2, 1987, Holdings delivered a proposal (the "First Holdings Proposal") to the Special Committee for the acquisition of the Company by Holdings in a merger transaction pursuant to which each holder of Company Common Stock, other than Holdings (which would hold not less than 6,881,000 shares of Company Common Stock at the effective time of the merger transaction pursuant to a capital contribution to it by National Amusements), would receive (i) $37.50 in cash, (ii) such fraction of a share of Exchangeable Preferred Stock of Holdings as would, in the opinion of the respective financial advisors of Holdings and the Company, have an expected market value on a fully distributed basis of $7.25 and (iii) the same common equity interest in the acquiring company as was contemplated by the MCV Merger Agreement.

On February 9, 1987, the Special Committee, after considering the advice of counsel and Goldman Sachs concerning, among other things, the relative certainty of, and estimated timetables for, consummation of an acquisition of the Company by MCV Holdings and Holdings, concluded that the First Holdings Proposal overall was not more favorable than the acquisition transaction contemplated by the MCV Merger Agreement.

On February 13, 1987, National Amusements, Holdings and their financial advisors and the Company executed a letter agreement pursuant to which National Amusements and Holdings were given access to certain information concerning the Company, in consideration of which Holdings and National Amusements agreed to maintain the confidentiality of such information and National Amusements and Holdings and such advisors agreed to certain restrictions relating to purchases of Company Common Stock.

On February 22, 1987, Holdings increased its offer (the "Second Holdings Proposal") to provide for a merger transaction pursuant to which each holder of Company Common Stock, other than Holdings, would receive (i) $40.50 in cash, (ii) such fraction of a share of Exchangeable Preferred Stock of Holdings as would, in the opinion of the respective financial advisors of Holdings and the Company, have an expected market value on a fully distributed basis of $6.00 and (iii) the same common equity interest in the acquiring company as was offered in the First Holdings Proposal. In addition, the Second Holdings Proposal provided that if the Merger was not consummated by April 30, 1987 (other than by reason of a breach by the Company of any of its obligations under the Merger Agreement), (a) interest would accrue on the cash portion of the Merger Consideration at an annual interest rate of 8% from May 1, 1987 to the date of the consummation of the Merger and (b) dividends would commence to accrue on the Exchangeable Preferred Stock from May 1, 1987.

In response to the Second Holdings Proposal, on February 26, 1987, MCV Holdings offered to increase the MCV Merger Consideration to (i) $38.00 in cash, (ii) such fraction of a share of MCV Exchangeable Preferred Stock as would, in the opinion of the respective financial advisors of MCV Holdings and the Company, have an expected market value on a fully distributed basis of $8.00 and (iii) shares of MCV Convertible Preferred Stock convertible, in the aggregate, into 25% of the common equity securities of MCV Holdings outstanding on a fully diluted basis immediately after consummation of the MCV Merger (the "First MCV Amended Offer").

Holdings responded to the First MCV Amended Offer by raising its offer, on March 1, 1987, to (i) $42.00 in cash, (ii) such fraction of a share of Exchangeable Preferred Stock as would, in the opinion of the respective financial advisors of Holdings and the Company, have an expected market value on a fully distributed basis of $7.50, and (iii) the same common equity interest offered in the Second Holdings Proposal (the "Third Holdings Proposal"). In addition, the Third Holdings Proposal increased the rate at which interest is to accrue on the cash portion of the Merger Consideration as described above to 9% per annum from May 1, 1987 to May 31, 1987 and to 12% per annum thereafter, while retaining the provision for the commencement of the accrual of dividends on the Exchangeable Preferred Stock on May 1, 1987.

On March 1, 1987, MCV Holdings submitted a revised offer to purchase the Company pursuant to a recapitalization merger in which the Company's shareholders would receive (i) $38.50 in cash, (ii) such fraction of a share of MCV Exchangeable Preferred Stock as would, in the opinion of the respective financial advisors of MCV Holdings and the Company, have an expected market value on a fully distributed basis of $8.50 and (iii) a fraction of a share of MCV Convertible Preferred Stock convertible, in the aggregate, into 45% of MCV Holdings' common equity securities outstanding on a fully diluted basis immediately following consummation of the MCV Merger (the "Second MCV Amended Offer").

On March 2, 1987, Holdings raised its offer (the "Final Holdings Proposal") to the Merger Consideration.

On March 3, 1987, the Special Committee met with its financial and legal advisors to review and consider the Final Holdings Proposal and the Second MCV Amended Offer. During the course of the Special Committee's deliberations, in the early morning of March 4, 1987, MCV Holdings revised the Second MCV Amended Offer by increasing the amount of MCV Exchangeable Preferred Stock included therein to $9.50 (the "Final MCV Amended Offer").

Goldman Sachs reviewed the Final MCV Amended Offer and discussed it with the Special Committee. Based on the Special Committee's review and consideration of the Final Holdings Proposal and the Final MCV Amended Offer, the Special Committee unanimously determined that the Final Holdings Proposal was more favorable to the public shareholders of the Company than the Final MCV Amended Offer, and that the terms of the Final Holdings Proposal were fair to, and in the best interests of, the Company and the shareholders of the Company (other than National Amusements) and unanimously determined to recommend that the Board of Directors approve the Merger Agreement and that the Board of Directors recommend the adoption of the Merger Agreement by the shareholders of the Company.

Subsequently, on March 4, 1987, a meeting of the full Board of Directors of the Company was held at which the principal terms of the Merger Agreement were reviewed and the Special Committee unanimously recommended that the full Board approve and authorize the execution and delivery of the Merger Agreement. Following such deliberations, the Board of Directors voted to approve and authorize the execution and delivery of the Merger Agreement, the eight members of the Special Committee voting in favor of such action and the four directors not serving on the Special Committee voting against such approval. The MCV Merger Agreement was terminated, and the Merger Agreement was executed, later the same day.

For a detailed discussion of the background of the Merger, see "BACKGROUND OF THE MERGER AND RELATED MATTERS—Background of the Merger".

Recommendation of the Company's Special Committee and Board of Directors

The Board of Directors recommends that the Company's public shareholders vote for approval and adoption of the Merger Agreement.

For a detailed description of the factors considered by the Company's Special Committee and Board of Directors and their reasons for approving the Merger, see "BACKGROUND OF THE OFFER AND RELATED MATTERS—Recommendations of the Company's Special Committee and Board of Directors; Reasons for the Merger".

Opinion of Financial Advisor

Goldman Sachs were originally retained by the Special Committee on behalf of the Company to act as the financial advisor to the Special Committee to advise the Special Committee as to the fairness of the amount of financial consideration to be paid to the public shareholders pursuant to the Initial MCV Proposal. Goldman Sachs have continued to act as financial advisor to the Special Committee in connection with negotiations leading to the MCV Merger Agreement, the Merger Agreement and the Merger, which negotiations were at all times subject to the approval of the Special Committee. No limitations were imposed by the Company or any of its affiliates with respect to the opinion rendered by Goldman Sachs, except that they were not authorized to solicit, and did not solicit, other potential purchasers of the Company or any of its constituent businesses. Goldman Sachs have delivered their written opinion to the Special Committee, a copy of which is appended hereto as Annex C, that, based upon and subject to the matters contained in such opinion letter, as of the date hereof the Merger Consideration to be received by the holders of Company Common Stock (other than Holdings, Acquisition or any other subsidiary of Holdings) pursuant to the Merger Agreement is fair to such holders. See "BACKGROUND OF THE MERGER AND RELATED MATTERS—Background of the Merger", and "—Opinion of Financial Advisor" and Annex C. Shareholders are urged to read the opinion of Goldman Sachs, which is set forth in its entirety in Annex C hereto, for a description of the procedures followed, assumptions made, areas of reliance upon others and other matters considered by Goldman Sachs in rendering such opinion. For information regarding the opinion and the fees paid or to be paid to Goldman Sachs, see "BACKGROUND OF THE MERGER AND RELATED MATTERS—Opinion of Financial Advisor".

Purpose of and Reasons for the Merger

National Amusements' purpose for causing Holdings to engage in the transactions contemplated by the Merger Agreement is to greatly increase National Amusements' equity interest in, and to obtain control of, the Company. Although National Amusements believes that an investment in Holdings involves significant risks, due principally to the highly leveraged consolidated capital structure of Holdings and the high debt service requirements, National Amusements, which is willing to assume such risks, believes that such financial leverage also presents the opportunity for correspondingly high returns. Conversely, the Company's shareholders are being given the opportunity to realize a significant proportion of the value of their Company Common Stock on a current basis, and are being asked to assume a significantly smaller proportion of the risks involved in an investment in Holdings. See "RISK FACTORS". For a more detailed description of National Amusements' purpose and reasons for the Merger, see "BACKGROUND OF THE MERGER AND RELATED MATTERS—Purpose of and Reasons for the Merger".

* * * *

Dissenters' Rights

Holders of Company Common Stock who do not vote in favor of the Merger may elect to receive the fair cash value

of their shares, based on all relevant factors and excluding any element of value arising from the accomplishment or expectation of the Merger, as claimed by them and agreed upon by the Company or as judicially appraised, and paid to them in cash, if the Merger is consummated. Such shareholders must deliver a written demand for payment of the fair cash value of their shares to the Company not later than 10 days after the vote on the Merger Agreement is taken at the Special Meeting and must comply with the other requirements of Section 1701.85 of the Ohio General Corporation Law (the "GCL"), the full text of which is attached to this Proxy Statement/Prospectus as Annex D. Any failure to comply with all such requirements may result in a forfeiture of dissenters' rights. See "RIGHTS OF DISSENTING SHAREHOLDERS".

* * * *

(Exhibits 2 and 3 to Mishkin Affidavit omitted in printing)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL ACTION No. 87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.

Plaintiff,

—vs.—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT INC., VIACOM INC., and VIACOM INTERNATIONAL, INC.

Defendants.

AFFIDAVIT AND ACCOMPANYING RULE 3(G) STATEMENT

ORAL ARGUMENT REQUESTED

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

IRVING MALCHMAN, being duly sworn, deposes and says:

1. I am a member of Kaufman Malchman Kaufmann & Kirby, counsel for plaintiff Ira Mendell.

2. I make this affidavit to set forth several facts that are not in dispute.

3. The original issuer herein was Viacom International Inc. ("old Viacom") whose common stock was listed and traded

on the New York Stock Exchange. The plaintiff, Ira Mendell, who owned 1,200 shares of the common stock of old Viacom, commenced the instant 16(b) action in January 1987.

4. As result of a corporate restructuring that occurred on or about June 3, 1987 ("restructuring"), old Viacom became the wholly owned subsidiary of Viacom, Inc. ("new Viacom") (Ex. A hereto, p.2). More precisely, a wholly owned subsidiary of new Viacom was merged into old Viacom, which thereby became the indirect wholly owned subsidiary of new Viacom (*Ibid*).

5. As a result of the restructuring, the shareholders of old Viacom received cash and also 17% of the common and preferred stock of new Viacom (Mishkin Aff., Ex. 1, pp.1-2). As noted, the name of new Viacom is "Viacom, Inc. (Ex. A) (instead of "Viacom International, Inc." (old Viacom)) and the common and preferred stock of new Viacom are listed and traded on the American Stock Exchange.

6. Prior to the restructuring, new Viacom was a shell corporation incorporated in Delaware for the purpose of acquiring old Viacom (Ex. A, p.2). The only significant asset of new Viacom is old Viacom (*Ibid.*).

7. As a result of the restructuring, plaintiff herein, who owned 1,200 shares of the common stock of old Viacom continuously at all times material to this action, is now a shareholder of new Viacom.

/s/ IRVING MALCHMAN
IRVING MALCHMAN

Sworn to before me this
20th day of June, 1988

(*Remainder of jurat omitted in printing*)

[Exhibit A to Malchman Affidavit]

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1987.
Commission File Number 1-9553.

Viacom Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	04-2949533 (I.R.S. Employer Identification No.)
200 Elm Street, Dedham, MA (Address of principal executive offices)	02026 (Zip Code)

Registrant's telephone number, including area code:
(617) 461-1600

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	American Stock Exchange
Cumulative Exchangeable Redeemable Preferred Stock, $0.01 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

As of March 22, 1988, 53,334,037 shares of Viacom Inc. Common Stock, $0.01 par value, were outstanding and the aggregate market value of such shares of Viacom Inc. Common Stock (based upon the closing price of $24⅝ of these shares on the American Stock Exchange on that date) held by non-affiliates was approximately $220,028,000.

PART I

Item 1. *Business.*

Background

Viacom International Inc. (sometimes hereinafter referred to as "Viacom", the "Company" or the "Predecessor Company") was organized in the state of Delaware in August 1970 as a wholly-owned subsidiary of CBS Inc. ("CBS") for the purpose of owning the television program distribution and cable television businesses of CBS. In June 1971, immediately after the transfer of these businesses to the Company, CBS distributed its interest in the Company to the holders of its common stock on a pro rata basis (the "Spin-Off"). The transfer of these businesses to the Company and the Spin-Off were necessitated by prohibitions of the Federal Communications Commission (the "FCC") against ownership by a television network of television program distribution or cable

television businesses. The Company was reincorporated in the state of Ohio on April 17, 1975.

Viacom Inc. (formerly known as Arsenal Holdings, Inc.) (sometimes hereinafter referred to as "Holdings") was organized in the state of Delaware in November 1986 for the purpose of acquiring the Company in a merger transaction and, prior to such merger had no significant assets and did not engage in any activities other than those incidental to its formation, such merger and the financing thereof.

On June 9, 1987, a wholly-owned subsidiary of Viacom Inc. was merged with and into the Company (the "Merger"). As a result of the Merger, the Company became an indirect wholly-owned subsidiary of Viacom Inc. which is an approximately 83% owned subsidiary of National Amusements, Inc., a closely-held corporation which owns and operates approximately 400 movie screens in 14 states.

Pursuant to an agreement of merger, dated as of March 3, 1987 (the "Merger Agreement"), each share of Viacom common stock (other than dissenting shares and shares held by Viacom, Viacom Inc. or a subsidiary of Viacom Inc.) was converted on June 9, 1987, into the right to receive (i) $43.20 in cash, (ii) 0.30097 of a share of Viacom Inc. Cumulative Exchangeable Redeemable Preferred Stock (the "Exchangeable Preferred Stock") accruing dividends from May 1, 1987 and (iii) 0.20 of a share of Viacom Inc. Common Stock (collectively, the "Merger Consideration").

General Development of Business

Viacom Inc.'s principal executive offices are located at 200 Elm Street, Dedham, Massachusetts 02026; its principal assets are investments in wholly-owned subsidiaries which own the common stock of the Company.

The Company is a diversified entertainment and communications company with its principal executive offices located at 1211 Avenue of the Americas, New York, New York 10036. The Company is principally engaged in the businesses of: television program and feature film distribution for television

exhibition in domestic and international markets, television program production and advertising service operations through its Entertainment Group; cable television operations through its Cable Division ("Viacom Cable"); the operation of satellite delivered entertainment networks for pay and advertiser-supported cable television through its Networks segment; and the ownership and operation of television and radio stations through its Broadcast Group.

The Company and its affiliated companies currently employ approximately 4,800 persons.

Financial Information About Industry Segments

The contribution to revenues and earnings before income taxes of each industry segment and the identifiable assets attributable to each industry segment for each of the three years in the period ended December 31, 1987, are set forth in Note 15 ("Business Segments") to the Consolidated Financial Statements of Viacom Inc. and the Company included elsewhere herein.

Financial Information About Foreign and Domestic Operations

Financial information relating to foreign and domestic operations for each of the three years in the period ended December 31, 1987, is set forth in Notes 13 and 15 ("Foreign Operations and Business Segments") to the Consolidated Financial Statements of Viacom Inc. and the Company included elsewhere herein.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL ACTION NO. 87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.

Plaintiff,

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT INC., VIACOM INC., and VIACOM INTERNATIONAL, INC.

Defendants.

NOTICE OF APPEAL

Notice is hereby given that Plaintiff, Ira L. Mendell, hereby appeals to the United States Court of Appeals for the Second Circuit from an order of the Court dated November 8, 1988, granting defendants' motion for summary judgment dismissing the complaint, and from each and every part thereof.

Dated: New York, New York
December 5, 1988

KAUFMAN MALCHMAN KAUFMANN & KIRBY

By: /s/ IRVING MALCHMAN
(A Member of the Firm)
919 Third Avenue
New York, New York 10022
(212) 371-6600

Attorneys for Plaintiff

To: CLEARY, GOTTLIEB, STEEN
& HAMILTON
One State Street Plaza
New York, New York 10004
(212) 344-0600

Attorneys for Defendants other than Viacom Incorporated, and Viacom International, Incorporated

HUGHES, HUBBARD & REED
One Wall Street
New York, New York 10005
(212) 709-7000

Attorneys for Defendants Viacom Incorporated, and Viacom International, Incorporated

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL ACTION NO. 87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.,

Plaintiff,

—against—

KEITH R. GOLLUST, et al.,

Defendants.

AFFIDAVIT

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

IRVING MALCHMAN, being duly sworn, deposes and says:

1. I am a member of Kaufman Malchman Kaufmann & Kirby, counsel for plaintiff Ira Mendell. I make this affidavit in support of the instant motion by plaintiff for an order pursuant to Fed. R. Civ. P. 60(b) relieving plaintiff of the order of the Court dated November 8, 1988 and the judgment of the Court dated January 17, 1989 which order and judgment granted defendants motion for summary judgment and dismissed the complaint.

2. Plaintiff, as owner of stock in Viacom International, Inc. ("International"), sued under Section 16(b) of the Securities Exchange Act of 1934 to recover short-swing profits made in the common stock of International. After commencement of the action and as a result of a corporate restructuring, International became the wholly-owned subsidi-

ary of Viacom, Inc. ("Viacom"). Also as a result of the restructuring, plaintiff became a shareholder of Viacom and was no longer a shareholder of International.

3. By opinion and order dated November 8, 1988 (Exhibit A hereto), the Court granted defendants' motion for summary judgment and dismissed the complaint. The basis of the Curt's [sic] opinion of dismissal was that plaintiff was no longer a shareholder of International, the original "issuer". Plaintiff duly appealed from the order of dismissal.

4. The Court subsequently entered judgment dated January 17, 1989 (Exhibit B hereto) granting defendants' motion for summary judgment and dismissing the complaint.

5. On January 9, 1989, before entry of judgment by the Court, plaintiff purchased a senior subordinated note of International, which is traded on the American Stock Exchange. A copy of plaintiff's confirmation slip for the purchase of this note is annexed hereto as Exhibit C. Plaintiff is thus now the owner of a security of International so that he now has unquestionable standing to maintain the instant 16(b) action.

6. On February 16, 1989, a pre-argument conference respecting plaintiff's appeal was held before the Hon. Stanley A. Bass, Staff Counsel of the Court of Appeals. It was determined that plaintiff's contention that he now has unquestionable standing to maintain this 16(b) action was a matter that should be first heard in this Court through a Rule 60 motion. Accordingly, plaintiff's appeal was placed upon inactive status provided that plaintiff made a Rule 60 motion by March 2, 1989 (Exhibit D hereto).

7. For the foregoing reasons, it is respectfully submitted that plaintiff's instant motion pursuant to Rule 60(b) relieving plaintiff of the Court's order of dismissal dated November 8, 1988 and the Court's judgment of dismissal dated January 17, 1989 should be granted in all respects.

/s/ IRVING MALCHMAN
IRVING MALCHMAN

Sworn to before me this
2nd day of March, 1989.

(Remainder of jurat omitted in printing)

(Exhibits to Malchman Affidavit omitted in printing)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of VIACOM INTERNATIONAL, INC. and VIACOM, INC.,

Plaintiff,

—against—

KEITH R. GOLLUST, *et al.*,

Defendants.

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

AFFIDAVIT OF EDWIN B. MISHKIN

EDWIN B. MISHKIN, being duly sworn, deposes and says:

1. I am a member of the bar of the State of New York and the bar of this Court and am a member of the law firm of Cleary, Gottlieb, Steen & Hamilton, attorneys for defendants herein other than Viacom International, Inc. and Viacom, Inc.

2. Attached hereto as Exhibit A is a true and correct copy of the first page of a Viacom International, Inc. prospectus, indicating that the bond purchased by plaintiff was part of an issue that was offered to the public in July 1988.

Dated: New York, New York
March 24, 1989

/s/ EDWIN B. MISHKIN
EDWIN B. MISHKIN

Sworn to before me this
23rd day of March, 1989

(Remainder of jurat omitted in printing)

[Exhibit A to Mishkin Affidavit]

PROSPECTUS

$500,000,000

Viacom International Inc.

$300,000,000 11.80% Senior Subordinated Notes due 1998
$200,000,000 11.50% Senior Subordinated Extendible Reset Notes

(Interest payable January 15 and July 15)

This Prospectus relates to the issuance by Viacom International Inc. (the "Company") of $300,000,000 aggregate principal amount of 11.80% Senior Subordinated Notes due 1998 (the "Senior Subordinated Notes") and $200,000,000 aggregate principal amount of 11.50% Senior Subordinated Extendible Reset Notes (the "Reset Notes" and, together with the Senior Subordinated Notes, the "Notes").

The Senior Subordinated Notes and the Reset Notes will be subordinated in right of payment to all of the Company's Senior Indebtedness (as defined) and will rank pari passu with each other and with the Company's outstanding 14.75% Senior Subordinated Discount Debentures due 2002 (the "Discount Debentures"). As of March 31, 1988, the outstanding amount of Senior Indebtedness was approximately $2.18 billion. Additional Senior Indebtedness and other Indebtedness (as defined) may be incurred by the Company from time to time, subject to certain restrictions in the Indenture. See "Description of Notes."

The Senior Subordinated Notes are redeemable at the option of the Company, in whole or in part, at any time on or after July 15, 1991, at the redemption prices set forth herein plus accrued interest, if any, to the date of redemption, except that the Company may not redeem Senior Subordinated Notes prior to July 15, 1993, directly or indirectly

from or in anticipation of borrowed funds having an interest cost of less than 11.80%.

The Reset Notes initially will bear interest at the rate of 11.50% per annum, through and including July 15, 1991. The Reset Notes will mature on July 15, 1991 unless the Company exercises its option (the "Extension Option") in such year, in which case the Reset Notes will mature on July 15, 1998. Unless otherwise consented to by its senior lenders, the Company must exercise the Extension Option. The Company may exercise the Extension Option at any time from May 15 to June 15 of 1991. If the Extension Option is not exercised, the Company will pay the principal amount of the Reset Notes, plus a premium of 1% of such amount on July 15, 1991. If the Extension Option is exercised, the interest rate on the Reset Notes, if necessary, will be increased on July 15, 1991 to a rate to be determined on the basis of market rates in effect on July 5, 1991 by two nationally recognized investment banking firms chosen by the Company (the "Reset Agents"), presently expected to be Drexel Burnham Lambert Incorporated and Bear, Stearns & Co. Inc. (or, in the event such firms cannot agree on such rate, by another nationally recognized investment banking firm chosen by the Company) as the rate that the Reset Notes should bear in order to have a market value of 100% of principal amount immediately after the resetting of the rate. In no event will the reset interest rate on the Reset Notes be lower than 11.50%. The redemption provisions applicable to the Reset Notes after July 15, 1991 will be determined by the Company in consultation with the Reset Agents prior to the interest rate reset.

Application has been made to list the Senior Subordinated Notes and the Reset Notes on the American Stock Exchange (the "ASE").

See "Risk Factors" for a description of certain factors that should be considered by investors.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public (1)	Underwriting Discount (2)	Proceeds to Company (1)(3)
Per Senior Subordinated Note...	100%	2.75%	97.25%
Total	$300,000,000	$8,250,000	$291,750,000
Per Reset Note	100%	2.75%	97.25%
Total	$200,000,000	$5,500,000	$194,500,000

(1) Plus accrued interest, if any, from July 28, 1988.

(2) The Company has agreed to indemnify the Underwriters against certain liabilities including liabilities under the Securities Act of 1933. See "UNDERWRITING."

(3) Before deducting expenses payable by the Company, estimated at $1,050,000.

The Notes are being offered by Drexel Burnham Lambert Incorporated and Bear, Stearns & Co. Inc. (the "Underwriters"), subject to prior sale, when, as and if delivered to and accepted by the Underwriters, and subject to approval of certain legal matters by counsel. It is expected that delivery of the Notes will be made against payment therefor on or about July 28, 1988, at the offices of Drexel Burnham Lambert Incorporated, 60 Broad Street, New York, New York.

Drexel Burnham Lambert INCORPORATED

Bear, Stearns & Co. Inc.

July 22, 1988

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

CIVIL ACTION NO. 87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.,

Plaintiff,

—against—

KEITH R. GOLLUST, *et al.*,

Defendants.

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

REPLY AFFIDAVIT
ORAL ARGUMENT REQUESTED

IRVING MALCHMAN, being duly sworn, deposes and says:

1. I am a member of Kaufman Malchman Kaufmann & Kirby, counsel for plaintiff Ira Mendell. I make this reply affidavit in support of the instant motion by plaintiff for an order pursuant to Fed. R. Civ. P. 60(b) relieving plaintiff of the order of the Court dated November 8, 1988 and the judgment of the Court dated January 17, 1989 which order and judgment granted defendants motion for summary judgment and dismissed the complaint.

2. Plaintiff purchased Internationl's [sic] note in January 1989. This purchase was made as soon as it occurred to plaintiff's counsel (1) that any security holder of International could maintain a 16(b) action here and (2) that notes of International were available to be purchased. As appears

from defendants' papers, these notes were not even issued by International until July 1988.

3. Plaintiff purchased the note for the reason that he did not want his meritorious 16(b) action to be defeated upon the technical ground of lack of standing because of a corporate restructuring which occurred after commencement of this action.

4. There was no litigation strategy to first litigate defendants' motion for summary judgment based upon lack of standing and then, if unsuccessful, to purchase International's note. Plaintiff had nothing to gain by unnecessarily litigating the motion for summary judgment when the entire problem of standing could have been obviated simply by purchase of the note.

/s/ IRVING MALCHMAN
IRVING MALCHMAN

Sworn to before me this
3rd day of April, 1989.

(Remainder of jurat omitted in printing)

States

... Augustus ... Gallery ... Institute ... Affairs, WJB ... Inc.,

Petitioners,

... Viacom Inc. and ... Inc.

Respondents.

... the United States ... for the Second Circuit

... Respondent Mendell

Irving Malchman
Kaufman Malchman Kaufman
& Kirby
... Third Avenue
New York, NY 10022
(212) ...

Attorney for Respondent Mendell

QUESTIONS PRESENTED

1. Whether Respondent lost his standing under 16(b) where (a) Respondent commenced his 16(b) action on behalf of the issuer months before the business restructuring in question, (b) in such restructuring, the issuer became the wholly owned subsidiary of a parent corporation, which was a shell corporation formed for the purpose of acquiring the issuer, with the issuer being the parent corporation's only asset, and (c) as a result of such restructuring, Respondent exchanged his stock in the issuer for cash and stock of the parent corporation so that Respondent has a continuing financial interest in the 16(b) action?

2. Whether Respondent's double derivative action, brought pursuant to both Rule 23.1, F.R.C.P., and Section 16(b), obviates Petitioners' objections to Respondent's standing to recover Petitioners' short-swing profits.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

Table of Authorities

Table of Authorities

STATUTES AND RULES

MISCELLANEOUS

Miscellaneous

No. 90659

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

v

IRA L. MENDELL, in behalf of VIACOM INC. and, alternatively, VIACOM INTERNATIONAL INC.,

Respondents.

BRIEF FOR RESPONDENT MENDELL

COUNTER-STATEMENT OF THE CASE

The original complaint, filed on January 6, 1987 (JA1[1]), was brought in behalf of Viacom International, Inc. ("International"), whose stock had been listed and traded on the New York Stock Exchange, to recover short-swing profits made in violation of 16(b) against the defendants herein (other than the nominal defendant, International) (40a, ¶ 7). As the result of a

1. References to the Appendices to the Petition for a Writ of Certiorari are cited "a." References to the Joint Appendix are cited "JA."

business restructuring that occurred on or about June 3, 1987 ("restructuring"), International became the wholly owned subsidiary of Viacom, Inc. ("Viacom") (JA28, ¶ 4).

As a further result of the restructuring, the shareholders of International received cash and also 17% of the common and preferred stock of Viacom (JA28, ¶ 5). The common and preferred stock of Viacom are listed and traded on the American Stock Exchange (*Ibid.*).

Prior to the restructuring, Viacom was a shell corporation incorporated for the purpose of acquiring International (JA28, ¶ 6). The only significant asset of Viacom is International (Ibid.). A subsidiary of Viacom merged into International, which thereby became the wholly owned subsidiary of Viacom (JA28, ¶ 4).

As a result of the restructuring, Respondent herein is now a shareholder of Viacom (JA28, ¶ 7).

After the restructuring of June 3, 1987, Respondent filed an amended complaint in March 1988 (JA2). The amended complaint was brought in behalf of Viacom or, alternatively, as a double derivative action in behalf of International (39a; 44a).

SUMMARY OF ARGUMENT

I.

As pointed out by the Second Circuit in its opinion herein (3a), the question of standing in this case is a threshold procedural question under 16(b), as distinguished from questions of substantive liability under 16(b). A 16(b) action is not a derivative action but instead is an independent statutory proceeding. The procedural strictures that obtain in a derivative action do not apply in a 16(b) action, such as the contemporaneous requirement; the immateriality of good faith or

reasonableness of business judgment respecting failure of board of directors to institute 16(b) action; inability of defendant insider to defend upon ground of lack of demand; etc. Any "security" holder of corporation—even a bondholder—may institute a 16(b) action.

Section 16(b) liability, which has been frequently described as a "crude rule of thumb", exists without proof of actual abuse of insider information, without proof of intent to profit on the basis of inside information, and thus, in short, without fault. Thus, 16(b) liability is not dependent upon harm or injury to the corporation or issuer. The corporation or issuer is simply the statutorily designated receptacle for 16(b) profits and, similarly, a 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. It follows that a broad and flexible interpretation of the 16(b) phrase "owner of any security of the issuer" — coupled with a recognition that Respondent fulfilled the express conditions of the statute that suit be "instituted" by a security owner of the issuer — is appropriate in order to implement the remedial purposes of 16(b) and prevent their frustration or evasion.

Standing under 16(b) is unimpaired in many types of corporate restructurings, such as mergers or asset purchases. In a case decided by this Court (*Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 586, ns. 9 and 10 (1978), where, after a restructuring, a second-tier subsidiary (which acquired all the assets of the original issuer) sued under 16(b) notwithstanding the continued existence of the original issuer and the standing of the second-tier subsidiary to do so was not questioned by anyone, including this Court. If in this case Viacom acquired International by merger of International into Viacom or purchased International's assets, any security holder

of Viacom (including an after-acquired security holder) could sue upon the 16(b) claim in this case. That International became Viacom's wholly owned subsidiary instead of merging into Viacom or instead of Viacom purchasing International's assets is mere happenstance insofar as 16(b) considerations are concerned.

For years it had been the law in the Second Circuit as the result of a leading district court decision (*Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966)) that where, as here, the original issuer continues to exist without, however, any public security holders, both the subsidiary (into which the issuer had been merged) and the parent became the "issuer" within the meaning of 16(b) so that an after-acquired stockholder of the parent had standing to sue under 16(b). In more recent years, decisions of the Seventh Circuit (2-1 decision) and the Ninth Circuit distinguished the analysis in *Blau*. Thereafter, the Second Circuit held against standing because, unlike *Blau*, which was distinguished, the issuer had never been merged out of existence. Then came the instant decision of the Second Circuit in this case.

The Second Circuit's decision in this case appropriately distinguished those cases holding against standing under 16(b) in corporate restructurings, including the penultimate Second Circuit decision, upon which the author of the opinion in this case sat as a member of the panel, because of the "novel situation" and "unique circumstances" of this case (16a; 17a). Here, the restructuring in question occurred during the pendency of Respondent's properly brought 16(b) action and the former shareholders of the issuer received in the restructuring stock of the parent (a shell corporation formed to acquire the issuer which became the parent's only asset) so that the former shareholders of the issuer, including Respondent, have a con-

tinuing financial interest in maintaining a 16(b) suit in behalf of the issuer. The fact that the restructuring occurred during the pendency of Respondent's 16(b) action presented the possible danger of an intentional restructuring such as would defeat 16(b). The Second Circuit further appropriately stated in its decision in this case that the threshold procedural question of standing under 16(b), as distinguished from questions of substantive liability under 16(b), should be "determined by whether the policy behind the statute is best served by allowing the claim" (12a) and that the broad meaning of the statutory language ("owner" of securities, which language is not modified by any limiting expression) "better accords with the remedial purpose of the statute." (15a).

The Second Circuit's decision sustaining Respondent's standing under 16(b) in this case is entirely correct. This Court itself has stated that the inevitable incompleteness of all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts. Far from doing violence to the statute, reading Section 16(b) to encompass Respondent's standing in the case fulfills the purpose of the provision to deter the abuse of insider information. Further, as discussed, the unique facts of this case are particularly compelling in favor of Respondent's standing.

Moreover, the separate corporate entities of International and Viacom should be disregarded in this case for the purposes of 16(b). As noted, Viacom is a shell corporation formed for the purpose of holding International (the original issuer), which is Viacom's only asset. International is thus clearly Viacom's instrumentality or alter ego. For the purposes of 16(b) in this case, Viacom should be considered to be the owner of International's 16(b) claim against petitioners. This Court has held that corporate form may be disregarded where, as here, it

produces an inequitable result, such as the defeat of a statute or public policy, even to extent of imposing liability upon the shareholders and even though the corporation was organized in good faith and was not a sham.

II.

It is established law that a double derivative action may be brought pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. In Respondent's double derivative action in this case, Respondent is enforcing, through the accepted and established procedure of the double derivative action, the right of Viacom as a shareholder of International to sue on behalf of International under 16(b). No special reason exists against the maintainability of a double derivative action in the context of 16(b).

ARGUMENT

POINT I

THE CORPORATE RESTRUCTURING IN THIS CASE DID NOT DIVEST RESPONDENT OF STANDING TO SUE UNDER 16(b)

A. A 16(b) Action Is A Broadly Remedial Statutory Proceeding In Contrast To The Restrictive Nature Of An Ordinary Derivative Suit

While a 16(b) action has some of the attributes of a derivative suit (a stockholder can sue and the recovery inures to the corporation), it is not derivative but instead is an independent statutory proceeding. *Dottenheim v. Murchison*, 227 F.2d 737 (5th Cir. 1956) (requirement of Rule 23 [now 23.1], F.R.C.P., that derivative complaint allege that stockholder was such at time of transaction complained of inapplicable to 16(b) action).

In *Dottenheim*, the Fifth Circuit stated (Id., 738):

> "The rules of law applicable to this case are neither complicated nor unusual. The statute here involved [Section 16(b)] creates a new cause of action, which, while similar in some respects to a secondary or derivative right, is not such a right at all. It is in reality a primary right. This is so because the statute which creates it makes it so."

To the same effect are *FDIC v. American Bank Trust Shares*, Inc., 558 F.2d 711, 716 (4th Cir. 1977); *Blau v. Oppenheim*, 250 F. Supp. 881, 885 (S.D.N.Y. 1966).

As pointed out by the Second Circuit in its opinion herein (3a), the question of standing in this case is a threshold procedural question under 16(b), as distinguished from questions of substantive liability under 16(b). A long and unbroken line of decisions liberalizes procedural requirements in 16(b) cases. As stated by Judge Irving Kaufman in *Epstein v. Shindler*, 26 F.R.D. 176, 178 (S.D.N.Y. 1960), in disallowing a counterclaim against the issuer in a 16(b) action: "'it is plain ... that it [16(b)] was primarily intended as an instrument of a statutory policy of which the general public is the ultimate beneficiary. Congress did not intend procedural restrictions to hamper such policy.'", quoting from *Benisch v. Cameron*, 81 F. Supp. 882, 884 (S.D.N.Y. 1948).

See, also, *Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir. 1954), *cert. denied*, 347 U.S. 1016 (holding, as does *Dottenheim*, that after-acquired shareholder may sue under 16(b) and requirements of Rule 23 [now 23.1] in a derivative action that the complaint allege that "the plaintiff was a shareholder ... at the time of the transaction of which he complains" is inapplicable in 16(b) action); *Magida v. Continental Can Co.*, 231 F.2d 843, 847-848 (2d Cir. 1956), *cert. denied*, 351 U.S. 972 (1956) (fact that there may be champertous relationship be-

tween plaintiff and his attorney is not a defense to a 16(b) action); *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984, 988 (2d Cir. 1947), *cert. denied*, 332 U.S. 761 (1947) (if issuer does sue under 16(b), intervention is freely granted to a shareholder "to guard against even the appearance of any concerted action"); *Pellegrino v. Nesbit*, 203 F.2d 463, 467 (9th Cir. 1953) ("any stockholder has a right to institute 16(b) suit if the corporation fails to do so, regardless of the good faith or reasonable business judgment of the board of directors."); *Prager v. Sylvestri*, 449 F. Supp. 425, 429 (S.D.N.Y. 1978) (demand requirement of 16(b) exists only for benefit of the issuer, so that the defendant insider does not have standing to assert lack of demand as a defense).

Unlike an ordinary derivative suit, any security holder of the corporation—even a bondholder—may prosecute a 16(b) action. Section 16(b) specifically provides that a 16(b) action may be maintained "by the owner of *any security* of the issuer" (emphasis supplied). The Exchange Act, in Section 3(a)(10), 78c(a)(10), defines "security" to include a "note ... bond [or], debenture". See, also, 2 Loss, *Securities Regulation* 1046 (2d ed. 1961) ("[i]t makes no difference [under 16(b)] whether the plaintiff's security is a stock or bond, registered or unregistered.").

B. The Corporation Or Issuer Is Simply The Statutorily Designated Receptacle For 16(b) Profits Irrespective Of Any Harm Or Injury To The Corporation Or Issuer

Section 16(b) liability has been frequently described as a "crude rule of thumb". E.g., *Foremost McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 251, n.26 (1976). Section 16(b) applies objectively so that it imposes liability without proof of actual abuse of insider information, without proof of intent to profit on the basis of such information, and thus, in short, without fault. *Foremost, supra*, at p. 251.

It follows that 16(b) liability is not dependent upon harm or injury to the corporation or issuer. Thus, "any 16(b) award to the corporation is essentially a windfall, since the corporation has suffered no harm for which it is being recompensed." *Blau v. Rayette-Faberg, Inc.*, 389 F.2d 469, 474 (2d Cir. 1968).

The corporation ("issuer") is simply the statutorily designated receptacle for the 16(b) profits. "The statute [16(b)] channels the insider profits back into the corporation, not to an informant or person directly suffering a loss." *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). The corporation or issuer may be an "instrument [which is] sometimes unwilling, for the effectuation of the statutory policy." *Magida v. Continental Can Co., supra* 231 F.2d at pp. 846-847. Hence, "the language and purpose of the statute preclude an estoppel based upon instigation by or benefit to the corporation whose shares are traded." *Ibid.*

Similarly, a 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. *Magida, supra* 231 F.2d, at pp. 846-47.

It follows that a broad and flexible interpretation of the 16(b) phrase "owner of any security of the issuer" — coupled with a recognition that Respondent fulfilled the express condition of the statute that suit be "instituted" by a security owner of the issuer — is appropriate in order to implement the remedial purposes of 16(b) and prevent their frustration or evasion.

C. Standing Under 16(b) Is Unimpaired In Many Types Of Corporate Restructurings (Such As Mergers Or Asset Purchases)

In *Western Auto Supply Co. v. Gamble Skogma, Inc.*, 348 F.2d 736, 739-41 (8th Cir. 1956), *cert. denied*, 382 U.S. 987

(1966), the original issuer merged, in a stock for stock exchange, into a second corporation which then transferred all its assets to a third corporation. It was held that both the second and third corporations could sue under 16(b) respecting a short-swing transaction in the original issuer's stock.

In affirming the district court upon the question of standing, the Eighth Circuit stated (*Id.* at 739):

> "In answering this proposition [of standing] affirmatively, the District Court relied principally upon the merger statute of Missouri, the State where the issuing corporation was incorporated. This statute simply operates to transfer to the successor corporation without further act or deed all rights, privileges, interests, property and liabilities, including choses in action which formerly belonged or were chargeable to the merged corporation. See Mo.Rev.Stat 351.450, V.A.M.S. (1959). The District Court also reasoned that since the legislative purpose of 16(b) was intended to protect property rights of the investing public as well as those of the issuing corporation, 16(b) must be broadly construed in reaching the decision that the chose in action here survived and was properly assigned." (footnote omitted)

Western Auto thus holds that the surviving corporation in a merger has standing under 16(b) and that the third corporation (to which the surviving corporation transferred all its assets) also had standing, notwithstanding the continued existence of the surviving corporation.

In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 586, ns. 9 and 10 (1978), the original issuer transferred all its assets, property and goodwill to a second-tier subsidiary of the first tier subsidiary of a public parent in

return for stock of the parent. The second-tier subsidiary sued under 16(b), and its standing to do so was not questioned by anyone, including this Court, notwithstanding the continued existence of the original issuer.

See, similarly, *Newmark v. RKO General, Inc.*, 425 F.2d 348, 352, n.4 (2d Cir. 1970) *cert. denied*, 400 U.S. 854 (1970), (surviving corporation in merger became owner of 16(b) claim and, further, security holder of surviving corporation, who never had been security holder of original issuer, had standing to sue under 16(b)); *Morales v. Lukens, Inc.*, 593 F. Supp 1209, 1211, n.4 (S.D.N.Y. 1984) (same, except that merger involved cash for stock).

Thus, if in this case Viacom acquired International by merger of International into Viacom or purchased International's assets, any security holder of Viacom (including an after-acquired security holder) could sue upon the within 16(b) claim. Petitioners contend that a contrary result obtains here because of the happenstance, insofar as 16(b) considerations are concerned, that International became Viacom's wholly owned subsidiary instead of merging into Viacom or instead of Viacom purchasing International's assets.

D. The Decisional Law Concerning The Effect Of Corporate Restructurings Upon Standing Under 16(b) Where, As Here, The Issuer/Subsidiary Continues To Exist Without, However, Any Public Security Holders

Blau v. Oppenheim, 250 F. Supp 881 (S.D.N.Y. 1966) was, for years, a leading case upon the law of standing under 16(b) in a corporate restructuring.

In *Blau* the initial issuer transferred all its "assets and choses in action" and also all its liabilities to the subsidiary of a public corporation whereupon the initial issuer was merged into the

subsidiary and ceased to exist (*Id.*, at p. 883). Subsequently, the plaintiff in *Blau* purchased stock in the parent public corporation and then sued under Section 16(b) to recover short-swing profits in the stock of the initial issuer (*Ibid.*).

Plaintiff and the Securities and Exchange Commission, appearing as *amicus*, argued that the statutory term "issuer" included both the parent public corporation and the parent's subsidiary which continued to exist (*Id.*, at p. 884).

The defendant argued that "since M&T [the surviving subsidiary] possessed the 16(b) right of action only as an assignee and not as an issuer, plaintiff's standing as a stockholder of American [the public parent] is necessarily derivative—in fact, double derivative—requiring compliance with Rule 23(b)." (*Id.*, at 886).

The district court in Blau rejected defendant's arguments and denied a motion by defendant to dismiss, stating (*Id.*, at pp. 886-87);

> "The court finds none of these arguments persuasive. There is no support for the defendant's position that Congress intended that suits for the recovery of short-swing profits be restricted to the initial issuer whose securities were the subject of the illicit gains and its securities holders, thus leaving no remedy in those instances where, as here, the issuer by a transfer of all its assets to another corporation has become extinct and is without its original security holders. It is true, as defendant states, that the section makes no reference to survivor or successor corporations of an issuer - but neither does it contain any bar against the maintenance of 16(b) suits by such corporations or their security owners. To deny them the right to maintain suit would serve to defeat the purpose of the law; to accord them the right serves to further it. The defendant's position, if accepted, would substantially cut down the availability of Section 16(b) as a remedy to security holders. Thus, under the defendant's concept, the right of security holders of an issuer to institute suit under Section 16(b) would be terminated whenever the issuer was merged with or succeeded by another corporation; the very act of dissolution of the issuer and the failure to bring suit by the date thereof would end the right of security holders to pursue the insider and have him disgorge his profits. This hardly conforms to the essential legislative policy of Section 16(b).
>
> "The defendant somewhat grudgingly concedes that his position, if upheld, would, as the SEC points out, enable unscrupulous insiders to arrange a merger or its equivalent to thwart the recovery of short-swing profits under Section 16(b). ..."

In *Blau*, as here, the subsidiary into which the original issuer had merged continued to exist and thus, as here, could sue under 16(b). *Blau* cited (Id., at p. 886, n.26) the analogous decision of the Eight Circuit in *Western Auto*, where, as noted, the original issuer merged into a second corporation which then transferred all its assets to a third corporation (the second corporation's parent) and the Eighth Circuit held that both the second and third corporations could sue under 16(b).

Blau represented the law upon the question of standing in corporate restructurings for many years and was cited approvingly by the Second Circuit. *Feder v. Martin Marietta Corporation*, 406 F.2d 260, 262 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970) and *Newmark v. RKO General, Inc.*, *supra*, 425 F.2d at p. 352, n. 4.

As pointed out, *Kern County Land, supra*, was also a case where, after a restructuring, a second-tier subsidiary sued under 16(b) notwithstanding the continued existence of the original issuer and the standing of the second-tier subsidiary to do so was not questioned by anyone, including this Court.

Then came the decisions in *Portnoy v. Kawecki Berylco Industries, Inc.*, 607 F.2d 765 (7th Cir. 1979) (2-1 decision) and *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) both of which distinguished *Blau*.

In *Portnoy*, the initial issuer (KBI), whose shareholders were cashed out, became the subsidiary (second tier subsidiary) of the first tier subsidiary of a public corporation (Cabot). A shareholder of the public grandparent (Cabot) sued under 16(b) to recover for short-swing profits in the stock of the initial issuer.

The majority in *Portnoy*, in holding that plaintiff did not have standing under 16(b), distinguished Blau upon the ground that in Portnoy the initial issuer still existed (Id., at pp. 768-9), and further stated that in any event "*Blau* went too far in granting standing to the plaintiff." (*Id.*, at p. 771).

The dissenting Judge in Portnoy stated (*Id.*, at p. 771):

> "Citing section 2(11) of the Securities Act of 1933 as an example, the majority says: 'Although the plaintiff's contention is not absurd on policy grounds, we cannot rewrite the statute to accommodate this situation. Congress has spoken clearly. When it wanted a broader definition of issuer, it drafted one.' But we need not rewrite the statute. Common sense tells us that by construction Cabot has become the issuer of the KBI stock within the definition of the statute. Put another way, KBI's identity for purposes of section 16(b) has been retained in Cabot. We should not expect Congress to divine-and provide for-all the possible corporate restructuring that, whether intentionally or not, can defeat the salutary purposes of the statute. The task of accommodating a statute to a given set of facts is for the courts. By such accommodation the purposes of section 16(b) can be satisfied and the laments of the majority for not being able to reach the result it seemingly longs for could be avoided."

In *Lewis*, the initial issuer, whose shareholders were cashed out, ceased to exist upon its merger into the subsidiary of a parent corporation. The Ninth Circuit held that the subsidiary succeeded to the initial issuer's 16(b) action (*Id.*, at p. 803) and assumed, *arguendo*, that the parent corporation had standing to sue under 16(b) as a shareholder of the subsidiary. The Ninth Circuit further held that plaintiff, a shareholder of the parent corporation, did not have standing to sue under 16(b) because the parent was not an "issuer" within the meaning of 16(b), stating that "[w]e decline" to follow the *Blau* analysis here." (*Id.*, at p. 804).

Thereafter, the Second Circuit decided *Untermeyer v. Valhi, Inc.*, 665 F.Supp. 297 (S.D.N.Y. 1987), summarily affirmed, 841 F.2d 1117 (2d Cir. 1988), and affirmed again in a *per curiam* opinion on rehearing, 841 F.2d 25 (2d Cir. 1988), *cert. denied*, 488 U.S. 868 (1988), which held against standing under 16(b) but which explicitly stated that it was not deciding contrary to the landmark decision in *Blau*.

In *Untermeyer*, the shareholders of the initial issuer (Sea-Land), a public corporation, were cashed out by another public corporation (CSX) and Sea-Land became the wholly owned subsidiary of CSX. Both Sea-Land and CSX had been totally separate and independent companies and the common stock of both Sea-Land and CSX had been listed and separately traded

on the New York Stock Exchange. Plaintiff, a shareholder of CSX, sued under 16(b) to recover short-swing profits that defendants therein had made in the stock of Sea-Land in violation of 16(b).

In *Untermeyer*, the Second Circuit sought to distinguish *Blau*, stating: "In *Blau*, the issuer had been merged out of existence ... Thus, unless the issuer's successor corporation or its parent was allowed to bring a section 16(b) action the short-swing profits illegally gained would never have been recovered....In contrast, the issuer here, Sea-Land, survived the merger and remains a viable corporate entity...Because Sea-Land remains a viable corporate entity, it or its shareholder, CSX, can bring an action under section 16(b) to recover the short-swing profits allegedly gained." (841 F.2d 25).

However, as pointed out by the Second Circuit in this case (13a), in *Blau*, there was a wholly owned subsidiary that was the successor of the issuer and both the subsidiary (the counterpart of Sea-Land in *Untermeyer*) and its parent (the counterpart of CSX in *Untermeyer*) could sue under 16(b).

Then came the instant decision of the Second Circuit in *Mendell* which is now before the Court upon grant of certiorari. Judge Cardamone authored the Second Circuit's opinion in *Mendell* and was also a member of the panel that decided *Untermeyer*.

E. The Second Circuit's Decision In This Case

The Second Circuit explicitly referred in its opinion herein to the "novel situation" and "unique circumstances" of this case (16a; 17a). Here, the restructuring in question occurred during the pendency of a properly brought 16(b) action and the former shareholders of the issuer received in the restructuring stock of the parent (a shell corporation formed to acquire the issuer

which became the parent's only asset) so that the former shareholders of the issuer, including Respondent, have a continuing financial interest in maintaining a 16(b) suit in behalf of the issuer.

The Second Circuit in its opinion herein distinguished *Portnoy* and *Lewis* as follows (16a-17a):

> "Contrary decisions of our sister circuits are similarly distinguishable. See *Lewis*, 762 F.2d at 801 (plaintiff shareholder of parent but never held stock in the issuer or its surviving subsidiary); *Portnoy*, 607 F.2d at 767-68 (cashout merger left plaintiff with no continuing financial interest in the litigation; plaintiff's alternative status as a shareholder in the grandparent corporation gave no standing for 16(b) suit on behalf of the issuer). In the case at bar, the conversion of International stock into Viacom stock presents a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer. We conclude, therefore, that under those unique circumstances the cases cited by defendants are neither controlling nor persuasive."

The opinion herein also distinguished *Untermeyer*, as follows (15a-16a):

> "[*Untermeyer*]...dealt with a plaintiff who owned stock of the parent corporation, but who never owned stock of the company that issued the shares traded in contravention of §16(b). 665 F. Supp. at 298. Thus, even without a merger, the *Untermeyer* plaintiff would not have had standing. In contrast, plaintiff here brought a valid §16(b) suit while he was a current shareholder of the issuer, and *but for* the merger standing would not be in issue here." (emphasis in original)

The Second Circuit in its opinion herein further distinguished its decision in *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977), *aff'd mem.* 573 F.2d 1295 (2d Cir. 1977) (16a):

> "In *Rothenberg v. United Brands Co.*, also cited by the district court, the shareholders received cash in the merger instead of securities. The crucial factor considered by the trial court was that in a cashout merger the former shareholders maintain no continuing financial interest in the litigation. See Rothenberg, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,692. In the present case all former International shareholders obtained, as a result of the merger, shares of International's parent corporation, and plaintiff, as one of them, continues to have at least an indirect financial interest in the outcome of this lawsuit. Two additional reasons caution against an overbroad application of *Rothenberg*: That decision noted that even if plaintiff had standing the 16(b) claim failed on the merits, *see id.* at 91,693-94; and the court's standing analysis was premised on an analogous application of Rule 23.1 which, as noted above, does not govern shareholders bringing §16(b) claims. Id. at 91,691-92."

The Second Circuit held, upon the unique facts of this case, that the threshold procedural question of standing under 16(b), as distinguished from questions of substantive liability under 16(b), should be "determined by whether the policy behind the statute is best served by allowing the claim" (12a) and that the broad meaning of the statutory language ("owner" of securities, which language is not modified by any limiting expression) "better accords with the remedial purpose of the statute." (15a).

The Second Circuit further stated: "A §16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy."(11a) In this regard, the Second Circuit also stated: "we cannot help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's §16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present." (17a).

It is the *form*, not the fact, of Viacom's acquisition of International that creates the standing problem here and the form of the acquisition was arranged after commencement of this 16(b) action. As pointed out, if Viacom had acquired International by merger or had purchased International's assets, no problem respecting standing would have arisen. It is a matter of public record that Petitioners sold a large block (8.4%) of International's stock to National Amusements, Inc. (which then formed Viacom to acquire International (JA31)) while National Amusements was on the verge of embarking on a contest to acquire International (JA 20-21; see also Schedule 13D Amendment No. 1, dated October 7, 1986, filed by Petitioners with SEC). Petitioners thus assisted National Amusements/Viacom to acquire International, a fact which would tend to ingratiate Petitioners with National Amusement/Viacom.

It is unrealistice to suppose that a subsidiary of National Amusements (which held Petitioners' proxy to vote Petitioners' International stock (Petitioners' Schedule 13D, *Ibid.*)) — either Viacom or International — would then turn around and sue Petitioners for disgorgement of monies that National Amusements had just paid. In that setting, absent the viability of a suit by public shareholders such as Mendell, there

would be no enforcement of Section §16(b), contrary to Congress's purpose in enacting the provision.

F. The Second Circuit's Decision Sustaining Respondent's Standing Under 16(b) Is Entirely Correct, Particularly In View Of The Unique And Compelling Facts Of This Case

As the Eighth Circuit stated in *Western Auto* in upholding standing under 16(b); "since the legislative purpose of §16(b) was intended to protect property rights of the investing public as well as those of the issuing corporation, 16(b) must be broadly construed" respecting the question of standing in corporate restructurings (348 F.2d at 739).

As further observed by the dissenting Judge in *Portnoy*: "We should not expect Congress to divine—and provide for—all the possible corporate restructuring that, whether intentionally or not, can defeat the salutary purposes of the statute [16(b)]. The task of accommodating a statute to a given set of facts is for the courts." (*Id.*, at p. 771).

This Court has similarly stated that "the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts." *United States v. Little Lake Misere Land Company, Inc.*, 412 U.S. 580, 593 (1973).

The long history of 16(b) dictates, we respectfully submit, that the Court ask itself whether the Congress that took such pains to guard against the issuer's being unwilling to sue one of its directors or officers—which is to say, by permitting *any* security holder of *any* kind to sue on the issuer's behalf—would have foregone the case of the initial issuer's having become a wholly owned subsidiary of another corporation in which plaintiff is a stockholder. The answer is clearly no.

Professor Blumberg states in his work, *The Law of Corporate Groups —Procedural Law*, p.363 (1983 ed.):

> "The controversy on the availability of the primary action centers on the weight to be given the literal provisions of section 16(b), which refer to an 'owner of any security of the issuer' and thereby literally exclude shareholders of the parent or grandparent of the issuer. In the complex corporate group, the interposition of an elaborate corporate structure, with tiers of companies between the corporate component in question and the public shareholder, would in many cases effectively disenfranchise public shareholders from instituting primary causes of action under section 16(b) with respect to constituent components. This is manifestly undesirable and a frustration of the purposes of the Act. An enterprise reading of section 16(b) seems clearly preferable to the literal construction adopted by *Portnoy*."

The unique facts of this case are particularly compelling in favor of standing. Respondent in this case owned 1,200 shares of International's common stock prior to the merger and he received in the merger not only cash but also the common and preferred stock of Viacom (a shell corporation formed for the purpose of holding International, its only asset) so that Respondent has a continuing financial interest in maintaining a 16(b) action in behalf of the issuer. Further, Respondent's 16(b) suit had been commenced prior, to and was pending at the time of, the corporate restructuring or merger, thereby presenting the possible danger of an intentional restructuring such as would defeat 16(b).

The SEC submitted an *amicus* brief below that supported the standing of Respondent Mendell under 16(b) in this case. The

decision of the Second Circuit herein thus has the support of the SEC. The Acting Solicitor General, on behalf of the SEC, is also appearing before the Court to support the Second Circuit's decision.

In a recent rulemaking, the SEC comprehensively revised its rules under Section 16. In a rule proposal and later reproposal, the SEC considered defining the term "owner of any security of the issuer" in Section 16(b) to encompass shareholders divested of their shares by a merger — as was Respondent Mendell[2]. In promulgating final rules, the SEC reaffirmed its view that a shareholder who is divested of shares as a result of a business combination transaction does not lose his Section 16(b) course of action, but, in light of the Court's grant of certiorari in this case, it determined not to adopt a proposed definition that would address the issue at this time[3].

G. Moreover, The Separate Corporate Entities Of International And Viacom Should Be Disregarded In This Case For The Purposes of 16(b)

As just noted, Viacom is a shell corporation formed for the purpose of holding International (the original issuer), which is Viacom's only asset. International is thus clearly Viacom's instrumentality or alter ego. This Court has held that corporate

2. See *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 263333 (Dec. 2, 1988, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 84, 343, at 89, 620; *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 27148 (Aug. 18, 1989), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 84, 439, at 80, 397 (reproposing revised defenition after receiving public comment).

3. *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 28869 (Feb. 8, 1991), at 87-88.

form may be disregarded where, as here, it produces an inequitable result, such as the defeat of a statute or public policy.

For the purposes of 16(b) in this case, the formal corporate distinction between Viacom and International should be disregarded and, instead, Viacom should be considered to be the owner of International's 16(b) claim against petitioners, thereby conferring upon any security holder of Viacom, such as Respondent, standing to sue under 16(b).

In *Flink v. Paladini*, 279 U.S. 59 (1929), a tugboat engineer injured on the high seas sued not only the corporate owner of the boat, a California corporation, but also its stockholders, under the provisions of the California Constitution and Civil Code that imposed pro rata liability on shareholders of California corporations for the debts of the corporation. The shareholders defended by claiming that the federal maritime statute limited the liability of the "owner" of a vessel for such injuries to the value of its interest in the vessel and pending freight. The Court construed the statutory term "owner" to include shareholders of the corporate owner, stating per Holmes, J. (*Id.*, at 62-63):

> "The Circuit Court of Appeals disposed of the case after a thorough discussion. It is unnecessary to do more than to make a short statement of the points. The purpose of the act of Congress was 'to encourage investment by exempting the investor from loss in excess of the fund he is willing to risk in the enterprise.' (citations) For this purpose no rational distinction can be taken between several persons owning shares in a vessel directly and making the same division by putting the title in a corporation and distributing the corporate stock. The policy of the statutes must extend equally to both. In common speech the stockholders would be

called owners, recognizing that their pecuniary interest did not differ substantially from those who held shares in the ship. We are of opinion that the words of the acts must be taken in a broad and popular sense in order not to defeat the manifest intent. This is not to ignore the distinction between a corporation and its members, a distinction that cannot be overlooked even in extreme cases (case citation), but to interpret an untechnical word in the liberal way in which we believe it to have been used—as has been done in other cases. (citations)"

In *Anderson v. Abbott*, 321 U.S. 349, *reh'g denied*, 321 U.S. 804 (1944), which involved federal statutes imposing double liability on "shareholders" of national bank, the Court disregarded corporateness and imposed the statutory double liability on individual shareholders of bank holding company that owned the national banks. After finding that the bank holding company was organized in good faith and was not a sham (*Id.*, at 356), the Court stated (*Id.*, at 361-363):

> "Normally the corporation is an insulator from liability on claims of creditors. The fact that incorporation was desired in order to obtain limited liability does not defeat that purpose. (citations) Limited liability is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted. But there are occasions when the limited liability sought to be obtained through the corporation will be qualified or denied. Mr. Chief Judge Cardozo stated that a surrender of that principle of limited liability would be made 'when the sacrifice is so essential to the end that some accepted public policy may be defended or upheld.' *Berkey v. Third Ave. Ry. Co.*, 244 N.Y. 84, 95, 155 N.E. 58, 61, 50 A.L.R. 599 (additional citations). The cases of fraud make up part of that exception. (citations) But they do not exhaust it. An obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability. (citations) That rule has been involved even in absence of a legislative policy which undercapitalization would defeat. It becomes more important in a situation such as the present one where the statutory policy of double liability will be defeated if impecunious bank-stock holding companies are allowed to be interposed as non-conductors of liability. It has often been held that the interposition of a corporation will not be allowed to defeat a legislative policy, whether that was the aim or only the result of the arrangement. (citations)...
>
> * * *
>
> "To allow this holding company device to succeed would be to put the policy of double liability at the mercy of corporation finance. The fact that Congress did not outlaw holding companies from the national bank field nor undertake to regulate them during the period of Banco's [bank holding company's] existence can hardly imply that Congress sanctioned their use to defeat the policy of double liability."

The corporate distinction between International and Viacom (formed as a shell corporation to hold International as its only asset) is gossamer. For the remedial purposes of 16(b) in this case, such flimsy distinction should be disregarded.

POINT II

RESPONDENT'S DOUBLE DERIVATIVE ACTION WHEREIN VIACOM SUES DERIVATIVELY UNDER 16(b) ON BEHALF OF INTERNATIONAL (THE INITIAL ISSUER) TO RECOVER PETITIONERS' SHORT-SWING PROFITS OBVIATES PETITIONERS' OBJECTIONS TO STANDING.

The amended complaint alleges, in the second cause of action, a double derivative action wherein Viacom sues derivatively under 16(b) on behalf of International (44a). The amended complaint alleges demand upon the Board of Directors of both Viacom and International (43a, ¶ 21) and, further, alleges that Respondent owned the stock of International prior to the restructuring and at all times material to his action (40a, ¶ 9).

In its opinion below, the Second Circuit stated: "Because the plaintiff [Respondent] has standing under 16(b), we do not reach the district court's rejection of plaintiff's standing argument based upon an alleged 'double derivative' action..." (18a). Upon this appeal, Respondent, as the respondent herein, urges upon the Court the validity of his double derivative action.

It is established law that a double derivative action may be brought pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. Thus, 3B Moore's, *Federal Practice*, ¶ 23.1.17, pp. 23.1-69 to 70 (1987 ed.), states:

> "An individual stockholder of a corporation which is a holding company holding stock of operating corporations may maintain a derivative action for the benefit of the operating corporations, joining them as parties, on the theory that the holding company could sue derivatively on behalf of the subsidiaries and that on failure of the holding company to act, plaintiff, its stockholder, may sue. There is nothing in Rule 23.1 to justify a contrary conclusion. Such a suit is known as a 'double derivative' action."

See, similarly, 7A Wright, Miller & Cooper, *Federal Practice & Procedure*, § 1821, pp. 4-6 ("Also covered by this rule [Rule 23.1] is the so called 'double derivative action' in which a stockholder of a parent corporation brings suit to redress a wrong allegedly done to a subsidiary corporation owned by the parent."); Note, "*Suits By A Shareholder In A Parent Corporation To Redress Injuries To The Subsidiary*," 64 Harv. L. Rev. 1313, 1314 (1951) ("Judicial acceptance of the double derivative suit has been almost without exception;")

Thus, the Second Circuit in *United States Lines v. United States Lines Co.*, 96 F.2d 148, 151 (2d Cir. 1938), directly held that a double derivative action is maintainable, as it did also in *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir. 1944), *cert. denied*, 323 U.S. 737 (1944).

In Respondent's double derivative action, Viacom is suing derivatively under 16(b) on behalf of International. "When a shareholder in the parent corporation seeks to enforce derivatively the parent corporation's derivative right to sue on behalf of the subsidiary, the suit which the shareholder brings has been labeled 'double derivative'" and the shareholder is enforcing a right 'twice derived.'" Note, 64 Harv. L. Rev., *supra*, at 1313.

In this case, Respondent is enforcing derivatively Viacom's derivative right to sue on behalf of International under 16(b). Respondent is thus enforcing, through the accepted and established procedure of the double derivative action, the right of Viacom as a shareholder of International to sue on behalf of

International under 16(b). The end result is that Viacom in effect is suing on behalf of International (the issuer) under 16(b).

No special reason exists for deciding against the maintainability of a double derivative action in the context of 16(b). On the contrary, the double-derivative action in this case subserves, rather than subverts, 16(b). On the contrary, also, as discussed, a long and unbroken line of decisions liberalizes procedural requirements in 16(b) cases.

Professor Loss states (V Loss, *Securities Regulation*, p. 3012 (1969 Supp.)):

> "When a 10 percent stockholder is itself a corporation and it does not bring an action, there is no reason why a stockholder of that corporation could not bring a derivative action, in the proper sense of the term, which, in so far as the 16(b) action is itself in the nature of a derivative action, would be really a double derivative action. This was done without comment by the court in *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968)."

In Blumberg, *supra*, p. 364, it is further stated:

> "There seems no sound reason why the alternative derivative remedy, relying on both Rule 23.1 and section 16(b), should not be available to a shareholder of the parent of the issuer. The adverse decision on the primary cause of action in *Portnoy* rested on a close reading of the provisions of section 16(b), which the court concluded did not give a primary cause to persons who were not literally shareholders of the issuer. But nothing in the decision suggests that a derivative cause of action to enforce a primary cause of action literally within the Act should not be available. Similarly, there is no basis for suggesting that the remedy to security 'owners' granted by section 16(b) was intended to be exclusive or to bar derivative actions that would otherwise be available.", citing Annot. 51 A.L.R. Fed. 793 (1981) ("it would appear that the stockholder of the parent should be able to maintain a derivative action to enforce the right of the parent [under 16(b)].")

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the court below sustaining Respondent's standing under 16(b) should be affirmed; or that, alternatively, the Court should sustain the maintainability of Respondent's double derivative action under 16(b).

Respectfully submitted,

IRVING MALCHMAN
KAUFMAN MALCHMAN
KAUFMANN & KIRBY
919 Third Avenue
New York, New York 10022
(212) 371-6600
Attorney for Respondent Mendell

Dated: March 13, 1991

(4)

No. 90-659

In the Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, ET AL., PETITIONERS

v.

IRA L. MENDELL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

JOHN G. ROBERTS, JR.
Acting Solicitor General

MICHAEL R. DREEBEN
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

JAMES R. DOTY
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

THOMAS L. RIESENBERG
Assistant General Counsel

BRIAN F. MCNALLY
Attorney
Securities and Exchange Commission
Washington, D.C. 20549

QUESTION PRESENTED

Whether, under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), a shareholder's properly instituted suit to recover short-swing profits from an issuer's statutory insiders may be maintained after a merger involving the issuer results in an exchange of the plaintiff's stock for cash and stock in the issuer's new corporate parent.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-659

KEITH R. GOLLUST, ET AL., PETITIONERS

v.

IRA L. MENDELL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission administers and enforces the federal securities laws, including the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.* Section 16(b) of that Act, 15 U.S.C. 78p(b), provides that officers, directors, and beneficial owners of more than 10% of an issuer's registered stock shall be liable to the company for profits realized from "short-swing" trading in the issuer's stock—a purchase and sale, or sale and purchase, within less than six months. Section 16(b) further provides that if the issuer refuses a demand for suit to recover such profits, "[s]uit * * * may be instituted * * * by the owner of any security of the issuer in the name and in behalf of the issuer." The issue in this case is whether a shareholder's properly instituted suit under

Section 16(b) must be dismissed when, as a result of the issuer's subsequent merger, the plaintiff is divested of his stock and receives, in exchange, cash and stock in the issuer's new corporate parent.

Section 16(b) plays a significant role in protecting against the misuse of inside information in the securities markets. Because of the ease with which corporate insiders and major shareholders can exploit informational advantages, Section 16(b) erects a strict, prophylactic rule that captures short-swing profits for the benefit of the issuer. Because only the issuer and its security holders—not the SEC—may institute actions under Section 16(b), it is particularly important that the deterrent force of that provision not be diluted.[1] Accordingly, the Commission has a strong interest in ensuring that the effectiveness of Section 16(b) is not jeopardized by unduly restrictive standing requirements imposed on security-owner suits.

STATEMENT

1. In January 1987, respondent Ira L. Mendell filed a complaint in the United States District Court for the Southern District of New York alleging that he was an owner of common stock of Viacom International Inc. (International), and that petitioners were liable to International for profits realized from certain transactions in International stock under Section 16(b) of the Securities Exchange Act, 15 U.S.C. 78p(b).[2] Pet. App. 4a. Respondent's complaint alleged that during 1986, petitioners collectively owned more than 10% of International's common stock and had realized approximately $11,000,000 in profits from short-swing trading. Respondent further alleged that in October 1986 he had made demand on International and its directors to institute an action under Section 16(b) to recover those profits, but suit had not been brought although more than 60 days had passed. Pet. App. 4a-5a.

[1] The SEC does enforce the reporting requirements of Section 16(a) (see 15 U.S.C. 78p(a), 78u), under which statutory insiders must report to the Commission their transactions in the issuer's stock, and, pursuant to its rulemaking powers, *e.g.*, 15 U.S.C. 78c(b) (authority to define "technical, trade, accounting and other terms"); 15 U.S.C. 78p(b) (power to exempt certain transactions from Section 16(b)); 15 U.S.C. 78w(a)(1) (general rulemaking authority), has promulgated rules to implement Section 16(a) and (b). See 56 Fed. Reg. 7242 (Feb. 21, 1991) (to be codified in scattered sections of 17 C.F.R.).

[2] The text of Section 16(b) is set forth in the appendix to this brief.

2. In June 1987, approximately six months after the complaint was filed, International was acquired through a merger transaction by Arsenal Acquiring Corporation (Arsenal), a wholly owned subsidiary of a company then called Arsenal Holdings, Inc., and now known as Viacom, Inc. (Viacom). Arsenal was merged into International, and International thereby became a subsidiary of Viacom. As part of this transaction, the shares owned by public shareholders of International were exchanged for a combination of cash and stock in Viacom. Accordingly, respondent, who was a shareholder of International when this action was instituted, became a shareholder of Viacom, International's new parent and sole shareholder. Respondent amended his complaint in response to the restructuring to allege a Section 16(b) action in behalf of Viacom as well as International. Pet. App. 5a, 31a-32a, 39a-45a; J.A. 27-28, 30-31.

Following the merger, petitioners moved for summary judgment, arguing that respondent lacked standing under Section 16(b) because he no longer owned International securities. The district court granted the motion, stating that "[s]uits to disgorge ill-gotten gains under § 16(b) may be prosecuted only by the issuer itself or the holders of its securities"; because respondent "no longer owns any International securities, he may not sue under § 16(b)." Pet. App. 32a.[3]

[3] The court also rejected respondent's argument that he had standing as a Viacom shareholder to assert a "double derivative"

3. The court of appeals reversed, concluding that respondent did not lose his standing under Section 16(b) by virtue of the merger in this case. The court began by noting that Section 16(b) is a remedial law that should be construed to fulfill Congress's purpose to prevent the exploitation of inside information by certain corporate insiders. Pet. App. 7a-10a. In light of the provision's background, the court stated that "[w]here differing constructions of § 16(b)'s terms are possible," the issue "whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim." *Id.* at 9a, 12a.

Here, the court found, the policy expressed in Section 16(b) favors respondent's standing. Because of the merger transaction, there were no public shareholders of International; only its parent corporation held International stock. Observing that it is "unrealistic" to rely on an issuing corporation to sue its insiders, the court found that to "leav[e] insiders to police themselves" is contrary to Section 16(b)'s objectives because it would thwart the "private shareholder enforcement purpose" underlying the provision. Pet. App. 13a-14a.

The court rejected petitioners' contention that the statutory language requires that a security holder lose standing if he ceases to hold his securities during the pendency of the action. In the court's view, the language of the statute requires no such result; it "speaks of the 'owner' of securities[,] but such language is not modified by the word 'current' or any like limiting expression." Pet. App.

action under Section 16(b). Pet. App. 33a. That issue was not reached by the court of appeals. *Id.* at 18a.

After the district court granted summary judgment, but before it entered a judgment of dismissal, respondent purchased a subordinated note issued by International, and moved, pursuant to Fed. R. Civ. P. 60(b), to vacate the judgment on the basis that he had standing under Section 16(b) as a noteholder. J.A. 35-36. The district court denied the motion, finding that the applicable standards under Rule 60(b) were not satisfied. Pet. App. 36a-38a. The court of appeals affirmed that ruling. *Id.* at 18a-19a.

15a. If Congress had intended to bar the maintenance of suits following the issuer's merger, the court noted, it could easily have done so. *Ibid.* The court also distinguished precedents holding that particular plaintiffs lacked standing when they were not current shareholders; in none of those cases had the plaintiff filed suit while holding the issuer's shares and later exchanged them for stock in the issuer's new parent. *Id.* at 15a-17a. Finally, the court noted that if petitioners' construction were accepted, it would open the door to "intentional restructuring" of a corporation in order to defeat a pending Section 16(b) claim instituted by a security holder. That result, the court stated, "would undercut the function Congress planned to have shareholders play in policing such actions." *Id.* at 17a.[4]

SUMMARY OF ARGUMENT

The court of appeals correctly held that respondent did not lose standing to maintain this action under Section 16(b) because of the post-suit merger in this case. The proposed standing restriction advocated by petitioners—that a security owner must continuously hold his shares throughout the suit—finds no support in the statutory language, would thwart the enforcement mechanism underpinning Section 16(b), and would introduce unwarranted anomalies into the application of the statute.

A. Section 16(b) creates a strict-liability rule that profits realized by statutory insiders from short-swing trading in the issuer's stock shall be disgorged to the issuer; it further provides that "[s]uit to recover such profit may be instituted * * * by the owner of any security of the issuer." 15 U.S.C. 78p(b). Respondent satisfied the requirements of the statute by "institut[ing]" this action as an owner of the issuer's common stock;

[4] Judge Milton Pollack, sitting by designation, dissented, arguing that the majority's ruling conflicted with the terms of the statute, Second Circuit precedent, and decisions of other courts of appeals. Pet. App. 20a-29a.

nothing in the text of the statute suggests that respondent was later divested of standing because of the issuer's post-suit merger. Indeed, the principle that statutory standing relates to the moment that the plaintiff files suit is quite familiar to the law.

B. The purposes and background of Section 16(b) confirm that there is no unstated "continuous ownership" requirement implicit in the statute. The paramount purpose served by Section 16(b) is to prevent statutory insiders from reaping short-swing profits in situations posing a risk of abuse, and to ensure that a wide pool of public security holders is available to perform a policing function. It would frustrate that purpose to allow insiders to evade their Section 16(b) liability because of the fortuity of a post-suit merger, in which the plaintiff's securities are exchanged for stock in the issuer's new corporate parent.

It would be particularly inappropriate to borrow a continuous-ownership requirement from the law of shareholder derivative actions; Section 16(b) consistently departs from that model in the direction of easing restrictions on security-holder suits. Any concerns about the adequacy of a post-merger plaintiff's interest in prosecuting suit can be addressed under well-established mootness principles; there is no need to import those principles into Section 16(b) to reach the anomalous result that respondent, who concededly has an adequate interest under Article III, loses his right to prosecute a properly instituted case.

C. Neither precedents nor the possibility of other remedies for insider trading justifies summarily ousting respondent from court. Although this Court's cases reflect a careful approach to the imposition of liability under Section 16(b), those cases do not suggest that standing principles under this remedial law should be construed narrowly. Nor are other possible legal remedies, with more complex elements of proof, adequate substitutes for the independent right provided by Section 16(b).

Finally, the few lower court cases that have articulated a "continuous ownership" requirement have done so in distinguishable contexts; no case involved a shareholder who properly instituted suit only to have his stock later exchanged in a business combination for stock in the issuer's new parent. Because respondent properly instituted this action as a shareholder of the issuer, and his financial interest continued following the post-suit merger, this action may be maintained under Section 16(b).

ARGUMENT

RESPONDENT'S PROPERLY INSTITUTED SECTION 16(b) ACTION WAS NOT SUBJECT TO DISMISSAL BECAUSE OF THE ISSUER'S POST-SUIT MERGER

A. The Plain Language Of Section 16(b) Does Not Support The Dismissal Of A Pending Action Because Of A Post-Suit Merger

The issue in this case is whether Section 16(b) imposes a "continuous ownership" requirement on a shareholder suing for the recovery of short-swing profits. Petitioners contend that the answer is "yes," such that a properly instituted Section 16(b) action must be dismissed where a post-suit merger divests the shareholder of his stock. In our view, the language of the statute renders that contention untenable. Although petitioners repeatedly urge (Pet. Br. 14, 19, 21, 25, 26, 41) that the "plain," "clear," "unambiguous," and "straightforward" language of the statute compels a "continuous ownership" requirement, exactly the opposite is true. The statutory language is satisfied when an action is "instituted * * * by the owner of any security of the issuer," as was this action; the statute says nothing—plainly or otherwise—about dismissing a plaintiff's suit after a merger involving the issuer exchanges the plaintiff's securities for stock in the issuer's new parent.

1. Section 16(b) is the only provision in the original Securities Exchange Act of 1934 that specifically addresses the problem of insider trading. It provides that a director, officer, or principal shareholder must disgorge to the issuing corporation "any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer * * * within any period of less than six months." 15 U.S.C. 78p(b). Section 16(b) was enacted "[f]or the purpose of preventing the unfair use of information which may have been obtained by [a statutory insider] * * * by reason of his relationship to the issuer." *Ibid.* Congress framed Section 16(b) as a "flat rule" to prevent the exploitation of inside information by the designated insiders. *Reliance Elec. Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 422 (1972); see S. Rep. No. 1455, 73d Cong., 2d Sess. 55-68 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).

Because of the difficulty of proving that an insider used inside information in his trading, Section 16(b) applies strict-liability principles. It deprives the insider of his short-swing profits, regardless of his intent or actual possession of inside information. See *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 592-593 n.23 (1973). The enforcement mechanism of Section 16(b) is equally simple. The Commission is not empowered to sue for disgorgement under Section 16(b); instead, Congress elected to rely exclusively on private actions brought by the issuer, or by a security holder of the issuer, seeking disgorgement of the short-swing profits.

To determine the requirements for security owners to sue under Section 16(b), "the starting point * * * is the language of the statute itself." *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 685 (1985); *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 110 S. Ct. 2126, 2130 (1990). The language authorizing security owner suits under Section 16(b) states:

> Suit * * * may be instituted * * * by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring suit within sixty days after request or shall fail diligently to prosecute the same thereafter.

15 U.S.C. 78p(b). Although petitioners purport to find in this language a "continuous ownership" requirement mandating that a security owner keep his securities throughout the life of a suit, the words simply do not say that. Section 16(b) empowers a security owner to "institute[]" an action; it does not impose any requirements that apply to the security owner's status after instituting suit. It follows that the provision is satisfied whenever, as here, the security owner owns his shares when the suit is initiated. Petitioners simply gloss over the actual language of the statute in insisting that it requires continuous ownership as a condition of standing.[5]

When Congress wanted to address the particular times at which a person must be a security "owner" for purposes of Section 16(b), it was capable of doing so with precision, as it did with respect to a beneficial owner *defendant*. Section 16(b) provides that a beneficial owner is not subject to disgorgement under the statute

---

[5] Petitioners effectively acknowledge that point when, in quoting the statute, they state (Pet. Br. 15) that their "continuous ownership" principle is "implicit" in Section 16(b). To justify their claim that the statute implicitly means something it does not say, petitioners observe that Section 16(b) grants standing to a shareholder to institute an action not only if the issuer fails to bring the action in the first place, but also if the issuer "fail[s] to prosecute it diligently." From this, they infer that a security owner must possess his interest throughout the action. But the statute's grant of standing to a security owner to "institute[]" a Section 16(b) action if the issuer fails to pursue it diligently does not suggest (implicitly or otherwise) that a security owner suit, once instituted, is subject to dismissal if a merger converts the security owner's interest into stock in a new parent. Rather, it demonstrates Congress's chief reliance on security owners (not issuers) to prosecute Section 16(b) actions. See p. 14, *infra*.

unless he is a 10% owner "both at the time of the purchase and sale, or the sale and purchase, of the security involved." 15 U.S.C. 78p(b). Likewise, if Congress had wanted to require a security owner *plaintiff* to be a shareholder "both at the time of instituting an action and during the entire period it is maintained," Congress easily could have said so.[6]

2. It is hardly a novelty that Section 16(b) does not require dismissal of an action because of a post-suit merger where the plaintiff had standing to sue at the moment the action was instituted; that approach to statutory standing is deeply rooted in the law. For example, in diversity cases, this Court has consistently held, from the early part of the 19th century to the present, that "if jurisdiction exists at the time an action is commenced, such jurisdiction may not be divested by subsequent events." *Freeport-McMoRan, Inc.* v. *K N Energy, Inc.*, No. 90-655 (Feb. 19, 1991) (per curiam), slip op. 2 (holding that subsequent addition of non-diverse party did not destroy diversity jurisdiction).[7] The same principle applies to jurisdictional amount-in-controversy requirements. Provided that the plaintiff has properly instituted an action by pleading a sufficient amount in controversy, even if the plaintiff "by stipulation, by affidavit, or by amendment of his pleadings, reduces the claim below the requisite amount, this does not deprive the district court of jurisdiction." *St. Paul Mercury Indemnity Co.* v. *Red Cab Co.*, 303 U.S. 283, 292 (1938).

[6] Cf. *Russello* v. *United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."); *General Motors Corp.* v. *United States*, 110 S. Ct. 2528, 2532 (1990); *International Org. for Masters* v. *Brown*, No. 89-1330 (Feb. 20, 1991), slip op. 9 n.10.

[7] The Court cited for this proposition *Mollan* v. *Torrance*, 22 U.S. (9 Wheat.) 537, 539 (1824) ("[T]he jurisdiction of the Court depends upon the state of things at the time of the action brought, and * * * after vesting, it cannot be ousted by subsequent events."); *Clarke* v. *Mathewson*, 37 U.S. (12 Pet.) 164, 171 (1838); and *Wichita R.R.* v. *Public Util. Comm'n*, 260 U.S. 48, 54 (1922) ("Jurisdiction once acquired * * * is not divested by a subsequent change in the citizenship in the parties.").

In keeping with that tradition, Congress made it sufficient for standing under Section 16(b) that an action be "instituted" by the owner of any security. See Yourd, *Trading in Securities by Directors, Officers and Stockholders: Section 16 of the Securities Exchange Act*, 38 Mich. L. Rev. 133, 156 & n.74 (1939) ("Section 16(b) permits suit 'by the owner of any security of the issuer' without regard to the time of acquisition of such security. * * * Presumably, ownership of the security at the time that suit is instituted is all that is required under section 16(b).").[8] The term "institute," then as now, refers to the commencement of a proceeding. A contemporary legal dictionary readily available to the 73d Congress defined "institute" to mean: "To inaugurate or commence; as to institute an action." *Black's Law Dictionary* 985-986 (3d ed. 1933) (citing cases).[9] Numerous federal statutes reflect the same usage.[10]

[8] Yourd's observation was made in the context of rejecting the application of the "contemporaneous ownership" rule to Section 16(b), see p. 19, *infra*, but the same reasoning applies to the "continuous ownership" rule advocated by petitioners.

[9] The same definition appears in the current *Black's Law Dictionary* 800 (6th ed. 1990), as well as in general dictionaries, see, *e.g.*, *Random House Unabridged Dictionary of the English Language* (2d ed. 1987) ("institute v., * * * 3. to set in operation: *to institute a lawsuit.*").

[10] See, *e.g.*, 2 U.S.C. 288k(a) ("any action or proceeding pending or to be instituted"); 8 U.S.C. 1503(a) ("action may be instituted only within five years after final administrative denial of such right"). Indeed, Congress has employed the word "instituted" when emphasizing that an action once filed is not subject to dismissal by particular post-suit events. See 42 U.S.C. 405(g) ("Any action instituted in accordance with this subsection shall survive notwithstanding any change in the person occupying the office of Secretary or any vacancy in such office.").

In light of that background, the "plain meaning" of Section 16(b) is not that a plaintiff must meet some requirement of "continuous ownership" not expressed in the statute. Rather, it is sufficient to establish standing for purposes of the provision's text if a security owner has properly instituted the action.[11]

B. The Purposes And Background Of Section 16(b) Indicate That Respondent's Action Survives The Issuer's Merger

Not only does a "continuous ownership" requirement rewrite the language of Section 16(b), it also conflicts with "the design of the statute as a whole and * * * its object and policy."[12] Imposing such a requirement would undermine Congress's paramount objective in enacting Section 16(b) by removing the class of plaintiffs Congress expected to serve as the primary enforcers. It

[11] Because respondent instituted this action while a security owner of the issuer, this case does not present the question whether a security holder has standing to sue if his shares were divested by a merger before he had time to file a complaint under Section 16(b). For example, an insider's sale that gives rise to Section 16(b) liability may occur simultaneously with a merger that divests all public shareholders of their stock; in that setting, no shareholder would be able to institute an action before ceasing to be an owner (particularly given the 60-day demand period). The issue there is whether Section 16(b)'s authorization of security owner suits encompasses suit by a former shareholder in order to prevent frustration of the statutory purpose. Cf. *Blau* v. *Oppenheim*, 250 F. Supp. 881, 886 (S.D.N.Y. 1966) (shareholders of a parent corporation whose subsidiary acquired the assets of a defunct issuer had standing to sue under Section 16(b) because "[t]o deny them the right to maintain suit would serve to defeat the purpose of the law"). This case also does not present the question whether the SEC by rulemaking could define "owner" to include, among other persons, such a former security owner. See note 30, *infra*.

[12] "In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy." *Crandon* v. *United States*, 110 S. Ct. 997, 1001 (1990); *Grogan* v. *Garner*, 111 S. Ct. 654, 659 n.13 (1991).

would be particularly inappropriate to borrow the "continuous ownership" requirement from the law of shareholder derivative actions, because Congress carefully departed from that model to make it easier for security owners to sue. And, a "continuous ownership" requirement is not compelled by standing principles developed under Article III.

1. *The background of Section 16(b) supports a broad construction of security holder standing.* Section 16(b) emerged from detailed examination of the securities markets in the wake of the 1929 stock market crash. The problem of corporate executives and major stockholders abusing their access to inside information was singled out as a particular source of concern for the integrity of the securities markets.

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). To remedy those abuses, and to restore investor confidence that corporate managers would fulfill their "responsibilities as trustees for their corporations," H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934), Congress enacted Section 16(b).

Not only the general policy of the provision, but its specific features reveal a purposeful effort to grant standing to security holders in an expansive fashion. *First*, although short-swing profits recovered under Section 16(b) flow into issuers' treasuries, Congress did not

rely on issuers alone, or even primarily, to enforce the provision. Rather, recognizing that issuers were unlikely to take action against their executives and major shareholders, Congress decided to harness the energies of security owners.[13] The statute's primary reliance on security holders is manifested in the fact that if the issuer, after demand, refuses to bring the action, or commences it but fails to pursue it vigorously, a security holder has the right to step in and institute suit.[14] And Section 16(b) presupposes that there will be a substantial pool of public security holders available to do so; its requirements apply only to companies with securities registered under Section 12 of the Act, 15 U.S.C. 78*l*, which, in general, includes securities traded on an exchange or in the over-the-counter market.

Second, Congress did not limit the possible plaintiffs under Section 16(b) to stockholders; rather, the class of plaintiffs is broadly defined to include owners of "any security" of the issuer; this includes, for example, holders of warrants, bonds, or other debt securities.[15] 15 U.S.C. 78c(a)(10); see *Reves* v. *Ernst & Young*, 110 S. Ct. 945, 948-949 (1990). The inclusion of debt holders underscores Congress's purpose to rely chiefly on a broad class of public security holders as the vehicle for enforcement for Section 16(b); it would not have been necessary to include a corporation's creditors if a direct benefit to investors were the motive of the provision.

[13] Issuers may also lack the incentive to pursue claims under Section 16(b) because the recovery is not compensatory in nature; the issuer has not experienced any out-of-pocket loss to spur its interest in pursuing a monetary remedy.

[14] *Pellegrino* v. *Nesbit*, 203 F.2d 463, 467 (9th Cir. 1953); *Cramer* v. *General Tel. & Elec. Corp.*, 582 F.2d 259, 276 n.22 (3d Cir. 1978) (dicta), cert. denied, 439 U.S. 1129 (1979).

[15] See Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 411 (1953) ("[D]ebenture holders, bondholders, and presumably even a bank holding a promissory note may undertake the litigation.").

Congress's expansive definition of the plaintiff class to include all security owners underscores its design to cast as wide a net as possible to ensure effective and vigorous private enforcement.[16]

Third, the Commission is not authorized to sue under Section 16(b). Consequently, if statutory insiders are protected from security-holder claims by the issuer's post-suit merger, the statute will frequently go unenforced. A rule that eliminates public shareholders as possible plaintiffs under Section 16(b) undercuts the policy of the provision to remove short-swing profits in cases "in which the possibility of abuse was believed to be intolerably great." *Reliance Elec. Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 422 (1972).

Because it would eliminate the favored class of persons on which Congress intended to rely for the enforcement of Section 16(b), petitioners' narrow rule of standing cannot be reconciled with the policy of the statute. It is no answer to observe that a post-merger issuer may, as here, still have one shareholder with technical standing to sue—its new corporate parent. Congress evidenced a healthy skepticism about the willingness of corporate executives to enforce Section 16(b), as demonstrated by its refusal to give corporations veto power over whether a shareholder can proceed under Section 16(b). That viewpoint has been borne out by experience. As the court of appeals observed, relying on issuers to sue statutory insiders "can be expected to secure the same results as

[16] In accordance with that policy, courts have held that security holders need not have a substantial interest to maintain an action; one or two shares will do. See, *e.g.*, *Portnoy* v. *Revlon, Inc.*, 650 F.2d 895, 897 (7th Cir. 1981); *Pellegrino* v. *Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953) (intervenor). The courts have also held that a particular plaintiff's reasons for suing are irrelevant. See *Magida* v. *Continental Can Co.*, 231 F.2d 843, 847-848 (2d Cir.), cert. denied, 351 U.S. 972 (1956).

* * * when a fox guards a chicken coop." Pet. App. 14a.[17]

The danger is particularly acute in mergers and acquisitions. Those transactions, by their nature, tend to cause short-range price fluctuations that insiders can exploit through their easy access to advance knowledge. Commentators have agreed that without suits by public holders of securities, Section 16(b) will frequently go unenforced in that situation. See ABA, Committee on Federal Regulation of Securities, *Report of the Task Force on Regulation of Insider Trading, Part II: Reform of Section 16*, 42 Bus. Law. 1087, 1134 (1987) (restrictive standing rules "effectively insulate[] conduct plainly prohibited by section 16(b) * * * , since after a friendly merger the 'parent' of the phantom subsidiary is unlikely to prosecute a section 16(b) action against the acquired company's former officers and directors"); P. Romeo, *Comprehensive Section 16 Outline* 70 (E.P. Executive Press, Inc. June 1989) (restrictions on shareholder suits following a merger "shield defendants of the acquired entity from short-swing liability in the vast majority of mergers, since the only party with standing to sue after the merger ordinarily is the surviving corporation, which usually has no interest in seeking recovery under Section 16(b)"). Moreover, if petitioners' approach became the law, it would invite corporations to engage in "intentional restructuring to defeat the enforcement mechanism incorporated in the statute." Pet. App. 17a.[18]

[17] See, *e.g.*, *Lewis* v. *McAdam*, 762 F.2d 800, 802 (9th Cir. 1985) (parent corporation, Sears, rejected a demand to sue the insiders under Section 16(b) because "it would be unseemly and contrary to Sears' best interests to seek recovery" of amount paid to insiders by Sears' subsidiary in a tender offer); *Untermeyer* v. *Valhi, Inc.*, 665 F. Supp. 297, 298 (S.D.N.Y. 1987) (parent attempted to conceal, after a merger, a statutory insider's short-swing transaction, and agreed to indemnify him against Section 16(b) liability), aff'd mem., 841 F.2d 1117, aff'd on reh'g, 841 F.2d 25 (2d Cir.), cert. denied, 488 U.S. 868 (1988). That a handful of Section 16(b) cases have reached this Court in which post-merger issuers were the plaintiffs does not support petitioners' optimistic hypothesis (Br. 32) that enforcement will be adequate without public security holders. In any event, Congress did not share that view.

Against the evidence that a "continuous ownership" rule would frustrate the remedial policies furthered by the statute, petitioners muster a scrap of legislative history, taken out of context, in which they find tangential support. Petitioners note (Br. 16) that during the legislative hearings Thomas G. Corcoran, a spokesman for the drafters, remarked that Section 16(b) would be enforced by "stockholders" who have an "interest" and "a private-profit motive" to recover for their "own account." *National Securities Exchanges—H.R. 7852: Hearings Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 136-138 (1934).

Those comments, however, do not address the standing requirements applicable to plaintiffs, let alone endorse petitioners' concept of "continuous ownership"; rather, they responded to concerns that it would be difficult to enforce a proposed prohibition (later dropped from the bill) against corporate insiders passing confidential tips to others. Even petitioners do not appear to take Corcoran's remarks as a literal description of Section 16(b) standing requirements, because Corcoran referred only to "stockholder" plaintiffs, while Section 16(b) allows suits by bondholders, warrant holders, and other security holders. See p. 14, *supra*. And if Corcoran's remarks were read to contemplate that plaintiffs must have a personal profit motive, that requirement is fully satisfied in this case. Respondent instituted his action while a stockholder of the issuer (International), and, through a business restructuring, became a shareholder of its corporate parent (Viacom). Because Viacom is the sole shareholder of International, and International is the parent company's only asset, Pet. App. 5a, respondent now

[18] Petitioners suggest (Br. 32) that other remedies are adequate to deal with the prospect of restructuring to evade Section 16(b) liability, but that assurance is not comforting in light of the substantial hurdles that those other remedies entail. See p. 24, *infra*.

stands to profit from the success of this action in much the same way as if he had never been divested of his original shares.

2. *The derivative action analogy does not apply to Section 16(b).* Examination of the source of the continuous ownership requirement further undermines its application to Section 16(b). The requirement stems from shareholder derivative actions governed by Federal Rule of Civil Procedure 23.1. As one court has noted, the requirement, "although not expressly stated in the rule, has been inferred from its language." *Lewis* v. *Chiles*, 719 F.2d 1044, 1047 & n.1 (9th Cir. 1983) (continuous ownership requirement flows from Rule 23.1's provision that the plaintiff must "fairly and adequately represent the interests of the shareholders * * * similarly situated").[19] It reflects the equitable nature of the derivative action, in which the shareholder "step[s] into the corporation's shoes * * * to seek in its right the restitution he could not demand in his own." *Ibid.*, quoting *Cohen* v. *Beneficial Indus. Loan Corp*, 337 U.S. 541, 548 (1949). It also acknowledges that the shareholder's interest is in enhancing the value of his stock by obtaining a recovery payable to the corporation. *Lewis* v. *Knutson*, 699 F.2d 230, 238 (5th Cir. 1983); *Kauffman* v. *Dreyfus Fund, Inc.*, 434 F.2d 727, 735-736 (3d Cir. 1970), cert. denied, 401 U.S. 974 (1971); *Papilsky* v. *Berndt*, 466 F.2d 251, 255 (2d Cir.), cert. denied, 409 U.S. 1077 (1972).

But neither Rule 23.1 nor the principles governing derivative actions are applicable here. Section 16(b) creates a "primary right" in security holders and is not controlled by the requirements of Rule 23.1.[20] For example, the key counterpart of the "continuous ownership" requirement in a derivative action is the "contemporaneous ownership" requirement—that the shareholder must have owned his shares at the time of the transaction challenged by the lawsuit. See Fed. R. Civ. P. 23.1; *Hawes* v. *Oakland*, 104 U.S. 450, 461 (1882); *Bangor Punta Operations, Inc.* v. *Bangor & A. R.R.*, 417 U.S. 703, 708 n.3 (1974). That restriction, however, has no application to Section 16(b); the owner of a security may institute suit "without qualification."[21] Moreover, while a plaintiff must qualify as a "shareholder" (an owner of equity stock) to bring a derivative action under Rule 23.1, any "security owner" (debt or equity) may institute an action under Section 16(b). And, in a shareholder derivative action, directors may refuse a demand for suit, and, in many cases, if their decision "represents an honest business judgment * * * , then a derivative action may not be maintained." 7C C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* § 1831, at 98 (2d ed. 1986). But under Section 16(b), security owners may institute actions notwithstanding the directors' refusal of demand or objection to suit. See *Burks* v. *Lasker*, 441 U.S. 471, 484 n.13 (1979).

These distinctions are revealing. Not only does Section 16(b) depart from the derivative model, it does so consistently in the direction of liberalizing a security owner's ability to sue. Petitioners, however, would in-

[19] See *Lewis*, 719 F.2d at 1047 n.1 (citing cases illustrating that this language "served as an anchor for the concept that ownership must extend throughout the life of the litigation"). No comparable language, of course, appears in Section 16(b).

[20] *Dottenheim* v. *Murchison*, 227 F.2d 737, 738 (5th Cir. 1955) (Section 16(b) does not create a "secondary or derivative" right and is not subject to procedural requirements of a derivative action), cert. denied, 351 U.S. 919 (1956); *Benisch* v. *Cameron*, 81 F. Supp. 882, 884 (S.D.N.Y. 1948) (Section 16(b) "was primarily intended as an instrument of a statutory policy of which the general public is the ultimate beneficiary. Congress did not intend procedural restrictions [applicable to derivative lawsuits] to hamper such policy."); Pet. App. 11a ("The standing requirements for shareholder derivative suits are not applicable to a § 16(b) plaintiff.").

[21] See *Blau* v. *Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), cert. denied, 347 U.S. 1016 (1954); *Dottenheim* v. *Murchison*, 227 F.2d at 740 & n.4; *Benisch* v. *Cameron*, 81 F. Supp. at 883-885. See also 13 W. Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 5981.2, at 232 & n.2 (rev. perm. ed. 1984).

voke derivative principles to achieve the opposite effect—to constrain a security owner's suit under Section 16(b). Br. 18. Indeed, petitioners' approach would be even more limiting of security owner suits than the traditional law governing shareholder derivative actions.

While the general rule is that a derivative action must be dismissed when the plaintiff's stock is taken by a merger, courts have recognized exceptions to the continuous ownership rule in that setting,[22] particularly where, as happened here, the plaintiff's interest is exchanged for stock in the new corporate parent.[23] Because the federal securities laws were intended to improve on the protections available under other sources of law, see *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 389 (1983), it would be especially inappropriate to imply a standing limitation under Section 16(b) that is more restrictive than the practice in conventional derivative actions.

3. *Article III considerations do not mandate a continuous ownership requirement.* That Section 16(b) does not require dismissal of a properly instituted suit because of a subsequent merger of the issuer does not mean that

[22] For example, Delaware law allows the plaintiff's action to continue "(1) where the merger itself is the subject of a claim of fraud; and (2) where the merger is in reality a reorganization which does not affect plaintiff's ownership of the business enterprise." *Lewis* v. *Anderson*, 477 A.2d 1040, 1046 n.10 (Del. 1984). See generally D. DeMott, *Shareholder Derivative Actions: Law and Practice* § 4:03, at 38-43 (1987 & Supp. 1990); Note, *Survival of Rights of Action After Corporate Merger*, 78 Mich. L. Rev. 250 (1979) (concluding that shareholders of corporation merged out of existence should be entitled to prosecute derivative actions when necessary to achieve equitable result).

[23] See *Gaillard* v. *Natomas Co.*, 173 Cal. App. 3d 410, 418, 219 Cal. Rptr. 74, 79 (1985) (allowing shareholder to continue her derivative action because her action was pending at the time of the merger, her financial interest in the suit endured, and dismissal would give "free reign to corporate pilfering" by virtue of a merger that management had arranged); *Alford* v. *Shaw*, 327 N.C. 526, 398 S.E.2d 445, 448-451 (1990) (refusing to dismiss derivative action where shareholder's stock was exchanged in a merger).

post-suit events are irrelevant. But petitioners are wide of the mark in contending (Br. 18-19) that a continuous-ownership requirement is "compelled" by this Court's standing jurisprudence under Article III.

An action under Section 16(b), like any action, can be mooted within the meaning of Article III by subsequent events. See *United States Parole Comm'n* v. *Geraghty*, 445 U.S. 388, 404 (1980). But the prospect of mootness somewhere on the horizon does not require that every statute be interpreted to oust from court every plaintiff whose claim *might* become moot. See *Gwaltney of Smithfield, Ltd.* v. *Chesapeake Bay Found., Inc.*, 484 U.S. 49, 66-67 (1987) (holding that a citizen suit under the Clean Water Act can go forward based on a continuing violation alleged to exist at the time of suit, subject to dismissal under Article III if the case becomes moot). Indeed, the facts of this case demonstrate that "continuous ownership" is not an indispensable condition to ensuring that a live case or controversy persists after a merger. Respondent's stock in International was exchanged not only for cash, but also for an equity interest in International's new parent. That interest indisputably gives respondent a live stake in the outcome—his pecuniary interest.[24] The same will be true in any stock-for-stock merger. Simply because *some* post-merger plaintiffs might lose their standing does not justify reading the statute to oust *all* post-merger plaintiffs from suit—particularly where the effect is to insulate short-swing profits from the recapture remedy envisioned by the statute.

[24] As one court explained in similar circumstances, "[t]he fact that a merger occurred here does not preclude Gaillard [plaintiff] from having a pecuniary interest in the outcome. Gaillard will, in fact, benefit from a favorable judgment. As a shareholder of Diamond [the new parent] she has a proprietary interest in the corporation which is the sole shareholder of Natomas [the original corporation in which she owned stock]. Thus, any benefit to Natomas by a damages award will increase the value of Natomas' stock." *Gaillard* v. *Natomas Co.*, 173 Cal. App. 3d at 418, 219 Cal. Rptr. at 79 (discussing derivative claim).

C. Neither Precedents Nor The Existence Of Other Remedies Requires The Dismissal Of Respondent's Action

In attacking respondent's standing, petitioners rely heavily on this Court's cases considering liability (not standing) issues under Section 16(b), the prospect of remedies under other provisions (whose elements are more difficult to prove than the elements of Section 16(b)), and decisions of lower courts embracing a continuous ownership requirement (in distinguishable situations). None of those considerations justifies the dismissal of respondent's action.

1. Petitioners contend that this Court's prior decisions support a narrow interpretation of Section 16(b)'s provisions. Br. 24 & n.10. But those prior cases consider the scope of liability under Section 16(b), not the standing of security owners to prosecute suit.[25] Because the statute "imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation," *Reliance Elec.*, 404 U.S. at 422, the Court has sought "to apply the statute only when its application would serve its goals," *Kern County*, 411 U.S. at 595, that is, when "the particular type of transaction involved is one that gives rise to speculative abuse." *Reliance Elec.*, 404 U.S. at 424 n.4.

Here, however, as the case comes to this Court, it must be assumed that petitioners' transactions expose them to liability under Section 16(b); the only issue is whether

[25] See *Blau* v. *Lehman*, 368 U.S. 403 (1962) (a partnership that traded in the issuer's stock was not liable under Section 16(b) simply because one partner was a director of the issuer); *Reliance Elec.*, 404 U.S. at 418 (sales occurring after the defendant had reduced his ownership to 9.96% did not give rise to liability under Section 16(b)); *Kern County*, 411 U.S. at 596-604 (a binding option to sell post-merger securities, posing no risk of speculative abuse, was not a "sale" under Section 16(b)); *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, 423 U.S. 232 (1976) (the defendant must be a 10% beneficial owner before his purchase of securities exposes him to liability under Section 16(b)).

the statute must be interpreted in a post-merger setting to destroy the opportunity of a public security holder to enforce petitioners' liability. Whatever reasons may support a strict analysis of the recapture rule of Section 16(b) in the liability setting, there is no reason to construe the statute restrictively in delimiting a plaintiff's standing to seek the statutory remedy where the effect would be to shield insiders not just from disgorgement, but even from having a court examine their liability on the merits.

2. Petitioners also argue that the availability of other remedies makes it unnecessary to grant standing to shareholders like respondent. Br. 32-34. But those alternative remedies cannot substitute for Section 16(b); they all involve significant procedural or other hurdles that Section 16(b) was enacted to surmount.

As petitioners note (Br. 33-34), other remedies under the federal securities law address the problem of insider trading. But the scope of Section 16(b) "is not affected by whether alternative sanctions might inhibit the abuse of insider information." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 255 (1976).[26] Moreover, the principal antifraud provisions, Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, require a showing of scienter, see *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), and those provisions—like other antifraud remedies—require a showing of actual possession of non-public information. See, *e.g.*, 15 U.S.C. 78t-1(a); 17 C.F.R. 240.14e-3. Section 16(b), in contrast, requires no showing of intent or actual possession. As many courts have noted, Section 16(b) is expressly designed to avoid complex problems of proof. See, *e.g.*, *Blau* v. *Lamb*, 363

[26] Although the Court in *Foremost-McKesson, Inc.*, 423 U.S. at 255, stated that alternative "sanctions alleviate concern that ordinary investors are unprotected against actual abuses of insider information in transactions not covered by § 16(b)," that reasoning has no application here, where the challenged transactions *are* presumptively covered by Section 16(b).

F.2d 507, 516 (2d Cir. 1966) ("the section's success as a deterrent [is] rooted in its simplicity and relatively automatic operation"), cert. denied, 385 U.S. 1002 (1967); 2 L. Loss, *Securities Regulation* 1043 (2d ed. 1961) (noting simplicity of the elements under Section 16(b)).

The simplicity of Section 16(b) also contrasts with the litigation obstacles awaiting plaintiffs attempting the other remedies offered by petitioners (Br. 32-33): a derivative action for breach of fiduciary duty, or a suit to enjoin or annul a merger on the ground that it was effected for an improper purpose. A derivative claim alleging breach of fiduciary duty is circumscribed by the procedural restrictions of Fed. R. Civ. P. 23.1, and may be vulnerable to dismissal based on the directors' business judgment. And a private action to enjoin a merger not only entails a substantial showing on the equitable factors needed for an injunction, but also places the burden on the plaintiff to establish an improper purpose for the merger. Clearly, those actions would not fill the gap created by petitioners' cramped construction of Section 16(b).

3. Finally, petitioners contend that a line of cases in the lower courts has adopted the continuous-ownership principle, and that any other rule produces unworkable results. Br. 14-15, 34-41. Neither contention is persuasive.

a. The few lower court decisions cited by petitioners involved significantly different facts than are presented here; their discussion of the implications of mergers for shareholder standing must be read in that context. As the Second Circuit pointed out, in two of the cases cited by petitioners, the plaintiffs had never held stock in the issuer, but simply held stock in the issuer's parent. Pet. App. 15a-16a, citing *Untermeyer* v. *Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), aff'd mem., 841 F.2d 1117, aff'd on reh'g, 841 F.2d 25 (2d Cir.) (per curiam), cert. denied, 488 U.S. 868 (1988), and *Lewis* v. *McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam). Courts have been unwilling to allow an action under Section 16(b) to

be instituted by a person who never was a security owner of the issuer.[27] But that principle does not apply here; respondent instituted this action while a shareholder of International, the undisputed issuer of stock in which petitioners made short-swing profits.

The Second Circuit also noted that in two other cases denying standing, the plaintiffs had been cashed-out by a merger, and therefore lacked a continuing financial interest in the suit. Pet. App. 16a, citing *Rothenberg* v. *United Brands Co.*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y.), aff'd mem., 573 F.2d 1295 (2d Cir. 1977); *Portnoy* v. *Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979). In contrast, this case does not involve a cash-out merger; respondent exchanged his stock in part for stock in the new parent, and therefore retains a financial interest in the action similar to what he held at the outset of suit.[28]

---

[27] As the courts below noted, Pet. App. 12a-13a, 32a, there is one longstanding exception to that principle, reflected in the decision in *Blau* v. *Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966). There, the director of an issuer allegedly realized short-swing profits before the issuer sold its assets to a subsidiary of another firm, merged into it, and then ceased to exist. A shareholder of the parent then brought suit under Section 16(b), and the court upheld the action, concluding that the term "issuer" in the statute embraced the parent company as well as the successor-in-interest to the defunct issuer. *Id.* at 884-888. That holding responded to the need to provide redress where the policy of the statute would otherwise be defeated. *Id.* at 886. The *Oppenheim* rule and its construction of the term "issuer," however, are not before the Court; unlike in *Oppenheim*, respondent was a shareholder of the issuer when he brought suit. Pet. App. 13a.

[28] The force of *Portnoy* as a precedent is also weakened by an additional factor: the plaintiff in that case expressly disclaimed any reliance on "the possibility [raised by the court] that the language of § 16(b) (that the suit may be 'instituted' by a shareholder of the issuer) could be read to mean that the plaintiff only be a shareholder at the time he filed the action." 607 F.2d at 767 n.4. Petitioners also cite (Br. 37) *Staffin* v. *Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981), where the district court simply followed

b. Nor does according standing to respondent introduce anomalies into the enforcement of Section 16(b); quite the contrary is the case. If International had merged into another corporation and respondent's stock had been exchanged for stock in the surviving firm, there would be no doubt that respondent, as a shareholder of the surviving firm, would have standing to continue his Section 16(b) action. Cf. *Newmark* v. *RKO Gen., Inc.*, 425 F.2d 348, 352 n.4 (2d Cir.) (shareholders of the surviving firm in a merger are "proper parties to bring an action" under Section 16(b) based on trading in the stock of the merger partner), cert. denied, 400 U.S. 854 (1970); *Morales* v. *Lukens, Inc.*, 593 F. Supp. 1209, 1211 n.1 (S.D.N.Y. 1984).[29] But under petitioners' view, the same shareholder loses his standing if the acquiring company, instead of merging the issuer into itself, forms a wholly owned shell subsidiary and merges it into the issuer. Despite the different corporate formalities, the substance of those two types of business combinations is identical. To allow standing in one case, but to deny it in the other, is to exalt the formal use of a corporate subsidiary over the real nature of the transactions.[30]

* * * * *

Portnoy and *Rothenberg* in the cash-out merger setting without independent analysis; the court of appeals affirmed on other grounds, 672 F.2d 1196, 1207 (3d Cir. 1982).

[29] The standing of shareholders in that situation is consistent with the rule that when an issuer is dissolved upon merging into another corporation, the surviving corporation acquires a right to enforce the former issuer's Section 16(b) claims. See *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736, 739-741 (8th Cir. 1965), cert. denied, 382 U.S. 987 (1966); *American Standard, Inc.* v. *Crane Co.*, 510 F.2d 1043, 1061 n.35, 1062 (2d Cir. 1974), cert. denied, 421 U.S. 1000 (1975).

[30] Petitioners also contend (Br. 27-29) that the SEC's rulemaking efforts to define the term "owner of any security of the issuer" suggest that there are practical obstacles in construing the statute to affirm respondent's standing. But under any of the SEC's formula-

Respondent properly instituted this action as a shareholder of the issuer, and his financial interest in the action continued following the issuer's merger. Rather than ordering this action to be dismissed because of post-suit events that did not impair respondent's concrete interest in proceeding, the court of appeals properly held that petitioners' Section 16(b) liability should be determined on the merits.

tions (as well as the statute itself), respondent could have pursued this action; the issues on which the SEC requested comment concerned whether other plaintiffs should also have standing. See *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 26333 (Dec. 2, 1988), [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620 (proposing definition of owner that would encompass "a beneficial owner of securities of the issuer at the time of suit," or a "former beneficial owner who was compelled to dispose of the securities because of a business combination"); *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 27148 (Aug. 18, 1989), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,439, at 80,397 (reproposing narrower definition that continued to encompass plaintiffs like respondent, and requesting comment on whether standing should be extended to, among others, "security holders who have notified the issuer of a short-swing transaction, but are compelled to surrender their securities because a business combination during the 60 days that the statute requires security holders to wait before instituting suit"). In light of the Court's grant of certiorari, the Commission determined not to define the term "owner" under Section 16(b) at this time. *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 28869 (Feb. 8, 1991), at 87-88.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

JOHN G. ROBERTS, JR.
Acting Solicitor General *

MICHAEL R. DREEBEN
Assistant to the Solicitor General

JAMES R. DOTY
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

THOMAS L. RIESENBERG
Assistant General Counsel

BRIAN F. MCNALLY
Attorney
Securities and Exchange Commission

MARCH 1991

* The Solicitor General is disqualified in this case.

APPENDIX

Section 16(b), 15 U.S.C. 78p(b), provides:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

The term "such beneficial owner" refers to a person who owns "more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 [15 U.S.C. 78*l*] of this title." Section 16(a), 15 U.S.C. 78p(a).

(7)

No. 90-659

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

Edwin B. Mishkin
(*Counsel of Record*)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners

TABLE OF CONTENTS*

---

* Reference is made to the information provided pursuant to Rule 29.1 of this Court on page ii of the Brief for Petitioners. No amendment is required to that listing in order to make it accurate as of the date of this Reply Brief.

TABLE OF AUTHORITIES

Cases PAGE

PAGE

REPLY BRIEF FOR PETITIONERS

The principal argument in the brief for the Securities and Exchange Commission in support of Respondent ("SEC Br.") is that the standing requirement of Section 16(b) is applicable only at the instant the plaintiff brings suit and, therefore, post-suit events, such as corporate mergers, by which a plaintiff ceases to own securities of the issuer do not cause a plaintiff to lose standing. This argument is directly contrary to all judicial precedent prior to the decision of the Court of Appeals in this case.[1] Indeed, it was not even made by the Commission in its brief to the Court of Appeals below or in its attempted rulemaking in this area. Moreover, even when advancing this argument, the Commission concedes that "some" mergers will cause a plaintiff to lose standing. The Commission does not, however, offer meaningful guidance to distinguish between those transactions that will cause the plaintiff to lose standing and those that will not. In fact, any such distinctions would be arbitrary, would be inconsistent with the statutory language and would serve no statutory purpose.

Respondent's position is even more elusive. He urges the Court to adopt a "broad and flexible interpretation" of the statute's standing requirement, to disregard "corporate form," including the separate existence of different corporate entities, in favor of "substance," and, if these arguments are insufficient, to treat his suit as a "double derivative" action so that he may sidestep Section 16(b)'s standing requirement entirely.

The Commission's and Respondent's arguments are unpersuasive. The Court should reject their invitation to rewrite the statute, and instead should apply it as it is written and hold that, since Respondent ceased to be "the owner of any

---

1 *See Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045, at 91,691-92 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 76[illegible], 767 (7th Cir. 1979); *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982).

security of the issuer," as required by the statute, he no longer has standing to maintain this action.

A. The Commission's New Approach To Standing, Like Respondent's, Lacks Any Articulable Rationale And Is Contrary To Legislative Intent As Well As The Language Of The Statute

Before the Court of Appeals below, the Commission argued that the language of the statute—"owner of any security of the issuer"—was broad enough to include a "former" owner. *See* Brief for the Securities and Exchange Commission, *amicus curiae*, at 3, 10-11, 15-16, 19-20, *Mendell v. Gollust*, 909 F.2d 724 (2d Cir. 1990) (No. 89-7068) ("SEC Br. *Ct. of App.*"). That argument was accepted by the Court of Appeals majority as a principal basis for its decision in this case. *See* 909 F.2d at 729-30; 14a-15a. Now before this Court, the Commission abandons this argument in favor of an entirely new one: because the statute states that a Section 16(b) action "may be instituted" by the owner of any security of the issuer, the plaintiff's status becomes irrelevant the instant after the action is commenced. SEC Br. at 5-6, 7, 8-12.

Under the Commission's new theory, a plaintiff could dispose of the securities that qualified him to sue immediately after bringing the suit and nevertheless continue to prosecute the action.[2] This is an obvious distortion of the statute. It would have been pointless for Congress to have required the plaintiff to be a security owner of the issuer in the first place if it intended that he be permitted to sell his securities the instant after bringing suit. This illogical result is hardly compelled by the use of the word "instituted."[3] *Cf. Lewis v. Anderson*, 477 A.2d 1040, 1045-46 (Del. 1984) (rejecting similar interpretation of Delaware statute governing "any derivative suit instituted by a stockholder").

The Commission's new theory of Section 16(b) standing, moreover, is every bit as artificial as its earlier one, and like Respondent's, equally contrary to Congress's intent in enacting Section 16(b)'s carefully circumscribed standing provision.

1. The Commission's Position, Like Respondent's, Requires The Federal Courts To Engage In Wholly Arbitrary Judicial Lawmaking Divorced From Legislative Guidance

a. Neither the Commission nor Respondent offers any defining rationale. Before the Court of Appeals below, the Commission argued that it was irrelevant for standing purposes when a Section 16(b) plaintiff owned his securities or whether such a plaintiff maintained an economic stake in the outcome of the suit.[4] Now before this Court, the Commission for the first time claims that timing is everything: Respondent must be accorded standing because he met the literal terms of the statute at the time the action was "instituted," and that is all the statute requires. SEC Br. at 8-12. On the other hand, the Commission concedes that its argument is not itself to be taken literally since it acknowledges that "*some* post-

---

2 Although the Commission addresses its argument to mergers, in which the security owner is divested of his securities by corporate action, the argument it makes would apply equally to instances in which the plaintiff disposes of the securities in the absence of corporate action, such as in sales into the market or pursuant to tender or exchange offers, including those that may precede a second step merger. *But see* note 7, *infra*.

3 The Commission's reliance on 42 U.S.C. § 405(g) for its interpretation of "institute," SEC Br. at 11 n.10, actually demonstrates the weakness of its position. Although that statute states that an action can be "instituted" against certain designated officials, Congress still felt it necessary to state that an action so "instituted" could be continued after there was a change in the identity of the person occupying the office. Such a proviso would have been unnecessary under the Commission's narrow reading of the term "instituted."

4 *See* SEC Br. *Ct. of App.* at 20 ("As this brief makes clear, . . . the Commission does not believe that either of these factors—filing a lawsuit prior to the merger or ownership of the parent's shares—is a statutory requirement for Section 16(b) standing.").

merger plaintiffs might lose their standing." *Id.* at 21 (emphasis in original).[5]

Within these vague constraints, however, neither the Commission nor Respondent offers any significant guidance for determining Section 16(b) standing. Instead, they urge that Section 16(b) standing should be interpreted "in an expansive fashion," SEC Br. at 13, and "broad[ly] and flexibl[y]," Resp. Br. at 9, while refusing to articulate any rationale for deciding the difficult standing questions that are bound to arise under their approach to the statute—including this very case.

The crux of the Commission's position is its contention that the role of Congress ended when it defined the interest that was necessary for a plaintiff to commence a Section 16(b) action, and that it is for the courts to divine in each case the requirements for a plaintiff to maintain such an action after it is commenced. Rather than offer this Court guidance for this exercise in judicial lawmaking, however, the Commission and Respondent steadfastly duck the issue and assert that this Court should simply find that, whatever the standard might ultimately prove to be, it has been met here.

5 This concession alone undercuts the Commission's specious, and completely inappropriate, attempt to draw an analogy between standing under Section 16(b) and diversity jurisdiction and amount-in-controversy cases. SEC Br. at 10-11. Moreover, those cases are strictly limited to jurisdictional questions relating to the subject matter of the cases federal courts are permitted to decide, and reflect a unique policy decision that courts will not reexamine the facts supporting these elements of jurisdiction after commencement of the action. *See* 13B C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 3608 (2d ed. 1984). Constitutional standing, however, together with ripeness and mootness (all of which are commonly referred to as "justiciability") is rooted in Article III's case or controversy requirement, and this Court has never held that such requirements need only be established at the commencement of the suit. *See, e.g., Rosado v. Wyman*, 397 U.S. 397, 404-05 & n.6 (1970) (distinguishing federal question jurisdiction, which is tested at the outset, from mootness, which may occur long after suit has begun, and analogizing the former to diversity jurisdiction or the amount-in-controversy requirement); *Golden v. Zwickler*, 394 U.S. 103, 108 (1969) (under declaratory judgment act suit, it was wrong for district court to assess standing based on the facts in existence when the action is initiated; proper inquiry was whether actual controversy existed at the time of the hearing).

The Commission and Respondent suggest that, in deciding the standing issue in this case, this Court should look to what they describe as the "remedial" purposes of the statute. SEC Br. at 17; Resp. Br. at 9, 18. Given their expansive view of those "remedial" purposes, however, it would be difficult to perceive why standing should be denied, under this test, in *any* case where a plaintiff ceases to own securities of the issuer.[6] Yet even the Commission does not contend, for example, that a security owner who commences a Section 16(b) action could maintain that action after voluntarily selling his shares on the open market for cash immediately after filing the complaint.[7] It is less clear what the Commission contends the result should be when a plaintiff's shares are sold pursuant to an all cash merger. In its brief, the Commission suggests that a plaintiff loses standing in that situation since he no longer would have a financial interest in the suit. *See* SEC Br. at 25. But in the Commission's 1989 Proposed Rule, the Commission would have permitted a plaintiff whose shares are surrendered in such a merger to continue to sue, and, in its brief to the Court of Appeals below, the Commission took the position that prior decisions denying standing to such plaintiffs were "incorrectly decided." *See* SEC Br. *Ct. of App.* at 3.

The Commission and Respondent say that this Court need not concern itself with deciding the impact its ruling would have on other cases or even with the criteria that would be

6 *See, e.g.*, SEC Br. at 15 ("Because it would eliminate the favored class of persons on which Congress intended to rely for the enforcement of Section 16(b), petitioners' narrow rule of standing cannot be reconciled with the policy of the statute."); Resp. Br. at 3 ("It follows that a broad and flexible interpretation of the 16(b) [standing requirement] . . . is appropriate in order to implement the remedial purposes of 16(b) . . . .").

7 The Commission's reproposed Section 16(b) standing rule, before it was withdrawn when the Court granted *certiorari* in this case, would have permitted a plaintiff whose shares were "surrendered" due to a merger to continue suit, but it would not have permitted a plaintiff to continue suit after voluntarily selling his securities. *See Ownership Reports and Trading By Officers, Directors and Principal Stockholders*, Exchange Act Release No. 34-27148, 44 SEC Docket 526, 533 (Aug. 18, 1989) (reproposed Rule 16a-1(g)) (hereinafter, the "1989 Proposed Rule"), *quoted in* Pet. Br. at 28.

considered in deciding those cases—since, according to them, applying the "remedial" purposes of the statute is sufficient to require a finding of standing here. But given their complete inability to articulate a rational basis on which these cases are to be decided—not to mention the shifting, and conflicting, positions the Commission has taken in this case and in its proposed rulemaking—how can the courts possibly be expected to do so? How, for example, would this Court, under the Commission's (or Respondent's) reasoning, decide the standing issue in the following cases (in each of which a publicly owned issuer becomes a wholly owned subsidiary of an acquiring corporation pursuant to a merger):

(i) A shareholder commences a Section 16(b) suit and then sells his shares after a proposed merger is announced.

(ii) A shareholder commences a Section 16(b) suit and then tenders his shares in a cash tender offer that is followed by a second step merger.

(iii) A shareholder commences a Section 16(b) suit and then surrenders his shares for cash pursuant to an all cash merger.

(iv) A shareholder commences a Section 16(b) suit and then surrenders his shares in exchange for shares of an acquiring corporation pursuant to an exchange offer that is followed by a second step merger.

(v) A shareholder commences a Section 16(b) suit, surrenders his shares for cash pursuant to an all cash merger and uses the cash to buy stock (or other securities) of the acquiring (parent) corporation.

(vi) A shareholder who owns stock in the issuer *and* in a corporation that proposes to acquire the issuer in an all cash merger commences a Section 16(b) suit before the merger and then sells his shares in the issuer into the market or surrenders them for cash pursuant to the merger but retains his stock in the acquiring (parent) corporation.

There is no principled basis, rooted in the "remedial" purposes of Section 16(b), to distinguish between situations in which, in response to an all cash merger proposal, the plaintiff voluntarily sells shares in the issuer into the market, tenders them pursuant to a first step tender offer, or surrenders them in the merger (cases (i)-(iii) above). Yet the Commission's 1989 Proposed Rule, continuing standing only for shareholders "required to surrender the securities due to such business combination," appears to make just such distinctions. If any such transaction results in a loss of standing (and the decided cases agree that they will in *all* such cases), is there any real basis to conclude that the transaction described in case (iv) above—an exchange offer in which the plaintiff tenders his securities in the issuer in exchange for securities of the acquiring (parent) corporation—should be treated differently, since that transaction is just as "voluntary" as the sale or tender of securities in response to a cash acquisition offer? And if a plaintiff's acceptance of an exchange offer will terminate his standing to sue, why is the situation different than the instant case, in which the plaintiff exchanged his shares in the issuer in a merger that was approved by a vote of the shareholders?

And is there any meaningful difference between a plaintiff who, after surrendering his shares for cash pursuant to an all cash merger, then uses the cash to buy the acquiring (parent) corporation's stock—as in case (v) above—and one who exchanges his shares in the issuer for the acquiring corporation's stock in the merger itself—as in the instant case? Apparently the Commission thinks so, because it suggests in its brief that a plaintiff loses standing if the merger is entirely for cash, SEC Br. at 25, but does not if the merger is in part for stock as in the instant case. But so far as the "remedial" purposes of Section 16(b) are concerned, there is no more (or less) reason to permit a plaintiff to maintain a Section 16(b) suit in one such case than in the other.[8] Similarly, there is no

8 The Commission's distinction between an all cash merger and a merger in which stock is issued is that in the latter case the plaintiff "retains a financial interest in the action similar to what he held at the outset of suit."

basis to distinguish between the facts in case (vi) above—in which the plaintiff owned securities in both the issuer *and* its acquiring corporation before an all cash merger and seeks to continue the suit after the merger—and those in the instant case. But the Seventh Circuit squarely held on those very facts that the plaintiff lost standing to sue. *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979).[9]

Moreover, contrary to the arguments of the Commission (and Respondent) in this Court, no "remedial" purpose is served by distinguishing between former security owners who sue before a merger and those who bring suit after the merger is effected, or between those post-merger parent corporation shareholders who once held shares in the acquired "issuer" corporation and those that did not. In its brief to the Court of Appeals below, the Commission explicitly acknowledged the similarity to each other and to the instant case of several prior court decisions in which standing was denied to plaintiffs who sued before a merger as shareholders

SEC Br. at 25. In the instant case, Respondent can hardly be said to have retained a financial interest similar to what he held before the merger since most of the consideration for his stock was cash and the public shareholders, who owned over 80% of the issuer before the merger, received less than 18% of the common stock of its new parent in the merger. *See* JA 11, 18. Moreover, the Commission's argument that the Respondent retains a financial interest in this litigation through his stock in Viacom is flatly inconsistent with the rule recently adopted by the Commission under Section 16 which states that a shareholder "shall not be deemed to have a pecuniary interest" in the securities held by a corporation unless the shareholder controls that corporation. *See Ownership Reports and Trading By Officers, Directors and Principal Stockholders*, Exchange Act Release No. 34-28869, 48 SEC Docket 216, 256, 257 (Feb. 8, 1991) (newly adopted Rules 16a-1(a)(2)(iii), 16a-l(g), to be codified at 17 C.F.R. §§ 240.16a-1(a)(2)(iii), 240.16a-1(g)).

9 It is no doubt because of the Commission's inability to offer any meaningful distinction between the instant case and *Portnoy* that it seeks to attack the force of *Portnoy* as a precedent. *See* SEC Br. at 25 n.28. No fair reading of the opinion in *Portnoy* would support the Commission's suggestion that the court in that case did not decide that the plaintiff lost standing to sue when he lost his shares in the issuer upon its merger with the acquiring corporation. *See Portnoy*, 607 F.2d at 767 ("However, he lost that status five days later, *and consequently, we are of the opinion that* he lost the standing that he had as an owner of KBI stock." (emphasis added)).

of the issuer,[10] to a plaintiff who was both a post-merger parent corporation shareholder and a prior shareholder of the issuer,[11] and to plaintiffs who were never shareholders of the issuer and who sued after the merger.[12] SEC Br. *Ct. of App.* at 3, 14-15. The Commission was correct in that acknowledgment in the court below: there *is* no meaningful difference between these cases, and the Commission's attempt now to portray them otherwise is not well grounded.[13]

b. The Commission's and Respondent's position ignores the standing requirement expressly adopted by Congress in Section 16(b). It is thus clear that the Commission's and Respondent's appeals to the "remedial" purposes of Section 16(b) provide no useful guide for distinguishing among former shareholders who may maintain a Section 16(b) action. It is equally clear that their suggestions have nothing to do with the language of the statute itself—which specifically addresses in unmistakable terms the kind of interest a Section 16(b) plaintiff is to have in the outcome of the litigation: ownership of securities *of the issuer.*

Even when filling in the interstices of federal statutory schemes, this Court has always insisted on using as its primary touchstone the intent of Congress as evidenced by the language of the statute at issue. As stated in *Pinter v. Dahl*, 486 U.S. 622, 653 (1988):

10 *See* cases cited note 1, *supra.*

11 *See Portnoy v. Kawecki Berylco Indus., Inc., supra.*

12 *See Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam); *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988).

13 The Commission's and Respondent's heavy reliance on the sole exception to this uniform body of precedent, *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966), *see* SEC Br. at 12 n.11, 25 n.27; Resp. Br. at 4, 11-16, is extraordinary in light of the weakness of the reasoning of that decision, the unanimity with which that decision has been criticized outside the Second Circuit and limited within it, and the inconsistency between that decision and the reasoning of the Court of Appeals majority below. *See* Pet. Br. at 37-38 n 18.

> [T]he Court has recognized that Congress had "broad remedial goals" in enacting the securities laws and providing civil remedies. . . . But the Court never has conducted its analysis entirely apart from the statutory language. "The ultimate question is one of congressional intent, not one of whether this Court thinks it can improve upon the statutory scheme that Congress enacted into law." The ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities Act must rest primarily on the language of that section. The broad remedial goals of the Securities Act are insufficient justification for interpreting a specific provision " 'more broadly than its language and the statutory scheme reasonably permit.' "

(citations omitted).

This approach has been applied to issues of standing under the federal securities laws. For example, in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733 (1975), this Court rejected arguments by the Commission for an expansive interpretation of standing to bring an implied action under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), insisting that standing be tied to the language of the statute.[14]

Blue Chip Stamps addressed the issue of standing to bring an implied right of action, where Congress had not thought at all about the issue of standing. It would be anomalous for this Court to have paid so much attention to the wording of the statute in deciding the limits on standing in that case, where Congress had not addressed standing at all, and to disregard the clear expression of intent embodied in the language of the statute here, where Congress addressed the standing question in unmistakable terms. The Commission's proposal—which now apparently requires strict adherence to

14 In *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977), the Court rejected the Commission's effort to expand standing to a competing tender offeror to bring an action under Section 14(e) of the Exchange Act, 15 U.S.C. § 78n(e), although the analysis rested on the legislative history rather than the language of the statute since Section 14(e) does not contain limiting language.

the language of the statute but only at the moment the action is "instituted," and then completely ignores that language the moment after—truly exalts form over substance, and its effort to expand standing beyond the scope called for by the language of the statute is every bit as unjustified here as in *Blue Chip Stamps*.

c. The Commission's and Respondent's arguments are not supported by the legislative history. The Commission's brief is virtually devoid of references to the legislative history of the statute.[15] Instead, it relies on the "purposes and background" of Section 16(b) for its argument that Congress intended post-commencement standing to be interpreted as broadly as possible.[16]

15 Respondent cites no legislative history to support his appeal for a "broad and flexible interpretation" of the statutory language. The only legislative history the Commission relies upon consists of citations in support of the uncontroversial proposition that "Congress framed Section 16(b) as a 'flat rule' to prevent the exploitation of inside information by the designated insiders," SEC Br. at 8, and in support of the proposition that Section 16(b) was based on, among other things, "concern for the integrity of the securities markets," *id.* at 13.

The Commission seeks to denigrate the force of the legislative history cited by Petitioners, Pet. Br. at 16, on the spurious grounds that (1) the legislative history was "taken out of context" since the precise provision that was at issue was ultimately removed from the statute, and (2) the spokesman for the drafters of the statute quoted by Petitioners "referred only to 'stockholder' plaintiffs, while Section 16(b) allows suits by bondholders, warrant holders, and other security holders." SEC Br. at 17. The Commission neglects to point out, however, that while the particular provision that was at issue was ultimately removed prior to passage of the statute, the enforcement scheme it contained which was being explained by Thomas Corcoran, *see* H.R. 7852, 73d Cong., 2d Sess. § 15(b)(3), was virtually identical to the enforcement scheme ultimately provided in Section 16(b) as enacted. Moreover, Corcoran's reference to suits by "stockholders" under this provision simply reflects a common way in which Section 16(b) suits are characterized. *See, e.g.*, SEC Br. *Ct. of App.* at 10, 18 (referring repeatedly to suits by security holders under Section 16(b) as suits by "shareholders").

16 Although the Commission's "purposes and background" arguments ultimately prove to be empty, this Court has repeatedly noted that where the language and legislative history of the statute are clear, there is no need to consider the purported "policy" behind the statute. *See, e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 n.33 (1976); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472 (1977); *Aaron v. SEC*, 446 U.S. 680, 695 (1980); *Randall v. Loftsgaarden*, 478 U.S. 647, 656 (1986).

The Commission's argument that standing must be read as broadly as possible because the statute only permits issuers and security holders, not the Commission, to sue makes no sense. If Congress had wanted to "cast as wide a net as possible," as the Commission hypothesizes (SEC Br. at 15), it certainly could have done so more easily than through the use of the narrow phrase "the issuer, or . . . the owner of any security of the issuer." The simple addition of the words "present or former" before "owner of any security," or a broader definition of the term "issuer" to include its parent corporation or other controlling persons,[17] would have done it. But Congress deliberately chose not to do so, just as it chose not to give the Commission the same enforcement authority under Section 16(b) that it has with respect to virtually every other provision of the federal securities laws. *See* Pet. Br. at 17 n.7. There is no basis for the Commission to argue that the absence of Commission enforcement authority evidences an intention to *expand* the persons entitled to enforce the statute.

Similarly, the Commission's argument that permitting mergers to terminate a plaintiff's standing will undercut the enforcement scheme of the statute is not only without foundation,[18] but it does not support a deviation from the standing requirements carefully considered by Congress. The Commission's policy argument applies as well to standing at

17 The term "issuer" is defined in Section 3(a)(8) of the Exchange Act, 15 U.S.C. § 78c(a)(8), to mean "any person who issues or proposes to issue any security." Where Congress wanted that term to include control persons, such as the parent corporation of the issuer, it knew how to say so. *See* Securities Act of 1933, § 2(11), 15 U.S.C. § 77b(11) (providing that, for purposes of the definition of "underwriter," the term "issuer shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer").

18 The Commission asserts that the enforcement scheme will be undermined because acquiring corporations will not sue former insiders of the acquired issuer following a merger. Not only is this contradicted by the two post-merger Section 16(b) cases to reach this Court, *see* Pet. Br. at 32, but the Commission makes no empirical showing to support its contention. *See* 5 L. Loss, *Securities Regulation* at 3012 (2d ed. Supp. 1969) ("Increasingly companies seem to be bringing their own suits.").

the commencement of the suit as it does to standing thereafter. Moreover, the principal evidence relied upon by the Commission to support this policy argument consists of a view expressed in 1987 by a subcommittee of the ABA's Committee on Federal Regulation of Securities. SEC Br. at 16. In citing this statement, however, the Commission ignores the more recent—and quite different—views expressed by the ABA Committee on Federal Regulation of Securities in addressing the Commission's Section 16 rule proposals.[19] In commenting on the initial rule proposals (described in Pet. Br. at 27-28), the ABA letter stated:

> We believe the proposed definition, even in its more narrow form, to be unsound in law and in policy. It is now settled law, as the Release itself notes, that former shareholders are not "owners" entitled to maintain an action under the statute. . . .
>
> From a policy perspective, we believe the proposed interpretation to be unsound. The function of the "owner" requirement of Section 16(b), *properly* including the plaintiff who purchases after the violation, is simply to ensure that the plaintiff has an economic interest in the litigation. To eliminate that nexus would be to recognize that the only interested party to the litigation is the lawyer who brings the action. *We believe this is a jurisprudentially unsound approach, even in the context in which the plaintiff has some continuing interest in the parent entity.* If the directly interested shareholder, who would benefit from the recovery, does not choose to bring the action, the Commission should not be seeking means by which lawyers can commence such actions without a directly interested client.

Letter from James H. Cheek, III, Chairman, ABA Committee on Federal Regulation of Securities, to Jonathan G. Katz,

19 For the Court's convenience, copies of the ABA's comment letters, which were part of the administrative record in the Commission's rulemaking proceeding and are on file with the Commission, are being lodged with the Clerk of the Court.

Secretary, Securities and Exchange Commission, dated March 13, 1989, at 20 (second emphasis added).[20]

2. Shareholder Derivative Action Principles Are Pertinent

The Commission and Respondent argue that principles applicable to shareholder derivative actions brought to enforce rights of corporations—which require a plaintiff to own the corporation's securities throughout the litigation—do not apply to Section 16(b) actions because such actions are not to be viewed as "derivative." SEC Br. at 18-20; Resp. Br. at 6-8.

Contrary to their position, Section 16(b) actions fall squarely within the definition provided by this Court in *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529 (1984): "[T]he term 'derivative action,' which defines the scope of [Fed. R. Civ. P.] 23.1, has long been understood to apply only to those actions in which the right claimed by the shareholder is one the corporation could itself have enforced in court." The Commission seeks to escape this by asserting that Congress intended Section 16(b) actions to be enforced "primarily" by security holders. This assertion, however, flies in the face of the statute itself, which permits security holders to sue *only* if the issuer refuses to do so after demand[21] or fails diligently to prosecute the action. Had Congress truly meant Section 16(b) to be enforced primarily by security holders, it would have eliminated standing for issuers altogether, as it did in Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b)—the statute at issue in *Daily Income Fund*.[22]

20 Similar views were expressed by the ABA committee in commenting later that same year on the Commission's 1989 Proposed Rule. *See* Letter from James H. Cheek, III, Chairman, ABA Committee on Federal Regulation of Securities, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated October 31, 1989, at 12.

21 *See* Brief for the Securities and Exchange Commission, *amicus curiae*, at 9, *Kamen v. Kemper Financial Services, Inc.* (Sup. Ct. argued Mar. 27, 1991) (No. 90-516) ("The demand requirement is integrally tied to the character of a derivative action as the assertion of a corporate claim.").

22 The Commission's argument that a Section 16(b) action is not derivative because it may be brought by any *security* holder, rather than just *share*holders, SEC Br. at 19, is also inconsistent with *Daily Income Fund*. The statutory provision at issue there also granted standing to any "security holder," rather than just shareholders, to bring an action against certain fiduciaries, but the sole ground for the Court's decision that such actions were not derivative actions subject to Fed. R. Civ. P. 23.1 was that, unlike Section 16(b), they could not be brought by the corporation in its own right.

The Commission is also wide of the mark in its characterization of Section 16(b) as designed to redress not a wrong to the issuer and its security holders, but a generalized public harm to the "integrity of the securities markets." SEC Br. at 13. The legislative history makes clear that Section 16(b) was enacted primarily to create a fiduciary duty on the part of corporate insiders to the corporation and its shareholders, and to prevent a perceived harm to the issuer and its investors arising from a breach of that duty. Indeed, this purpose is manifest in the very portions of the legislative history cited by the Commission (*see id.*):

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant *betrayal of their fiduciary duties* by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities.

S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934) (emphasis added). The same congressional report later stated:

> The [Exchange Act] aims to protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations by *preventing them from speculating in the stock of the corporations to which they owe a fiduciary duty*. . . . In the event that he realizes any profits from [short-swing trading], he is bound to account to the corporation for such profits. . . .

Id. at 68 (emphasis added).

Statements by two of the principal drafters of the Exchange Act, Thomas Corcoran and Ferdinand

Pecora,[23] virtually remove any doubt about the proper characterization of Section 16(b) claims. In testimony before Congress, Corcoran made the following explanation of the rationale for Section 16(b):

> [Section 16] [f]orbids [a corporate insider] to carry on any short-term specualtions [sic] in the stock. He cannot, with his inside information get in and out of stock within six months. If he does, the profit goes to his company. That is simply an application of an old principle of the law that if you are an agent and you profit by inside information concerning the affairs of your principal, your profits go to your principal.

Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 133 (1934). In colloquy during Senate hearings, Pecora made a similar statement:

> [Section 16(b)] is designed avowedly to prevent insiders from utilizing their position to trade for their own account and against the interest of the general body of the stockholders. The only penalty against it . . . is that he has to disgorge his profits for the benefit of all the stockholders.

Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency, 73d Cong., 2d Sess. 7742 (1934).

The courts have confirmed that the statute redresses a wrong to the corporation and its shareholders, rather than an injury to the public generally. *See, e.g., Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 740 (8th Cir. 1965) ("An award for profits made by an insider in a short swing transaction under § 16(b) has been characterized without exception as non-penal, remedial compensation to protect property rights of the corporation and its investors for breach of the insider's fiduciary relationship."), *cert. denied*, 382

23 The role played by these two in the passage of the legislation is described in *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 246, 250 n.24 (1976).

U.S. 987 (1966); *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959).[24]

Finally, the Commission also implies that even if Section 16(b) were considered to be a derivative action, the law governing derivative actions would not divest a plaintiff of standing in these circumstances. SEC Br. at 20. This is simply not true. Courts applying federal law have consistently held that loss of shareholder status divests a plaintiff of standing to maintain a derivative action,[25] and the same result generally applies under state law as well.[26] Although some courts have created extremely limited exceptions to the continuous ownership requirement,[27] the Commission has cited no case

24 The Commission cites general language in the legislative history of Section 16 purportedly indicating that the provision had a broad purpose of ensuring "the integrity of the securities markets," SEC Br. at 13, which would suggest it was intended to serve interests broader than just those of the issuer and its investors. Even if this additional purpose could be gleaned from the language cited by the Commission, however, the fact that Section 16(b), like all of the Exchange Act, also served broader "market integrity" interests, *see* Exchange Act § 2, 15 U.S.C. § 78b, no more justifies an open-ended expansion of standing than it did in *Blue Chip Stamps* and *Piper*.

25 *See, e.g., Lewis v. Knutson*, 699 F.2d 230 (5th Cir. 1983) (loss of standing through involuntary loss of shares through reverse share split); *Schilling v. Belcher*, 582 F.2d 995, 999-1002 (5th Cir. 1978) (under federal and Florida law, purchase of all shares of corporation by acquiring corporation after verdict favorable to plaintiff divests plaintiff of standing); *Fischer v. CF&I Steel Corp.*, 599 F. Supp. 340 (S.D.N.Y. 1984) (plaintiff loses standing to maintain derivative antitrust action through reorganization in which plaintiff's shares are exchanged for shares of new holding company); *Orenstein v. Compusamp, Inc.*, 19 Fed. R. Serv. 2d (Callaghan) 466 (S.D.N.Y. 1974) (loss of standing through voluntary sale alleged to have been fraudulently induced).

26 *See, e.g., Heit v. Tenneco, Inc.*, 319 F. Supp. 884 (D. Del. 1970) (Delaware law: loss of standing to maintain state law derivative action after merger in which plaintiff's shares were exchanged for stock of grandparent corporation); *Prudential-Bache Sec., Inc. v. Matthews*, 627 F. Supp. 622, 623-24 (S.D. Tex. 1986) (Texas law: cash-out merger divests standing both for plaintiffs who voluntarily tendered shares for cash in first step of two-step merger and for plaintiff who involuntarily lost shares in second step merger).

27 *See, e.g., Arnett v. Gerber Scientific, Inc.*, 566 F. Supp. 1270, 1273 (S.D.N.Y. 1983) (applying federal law: plaintiff does not lose standing to maintain a derivative antitrust claim where "(1) plaintiffs' disposition of the stock was involuntary; (2) the disposition was related to the allegedly illegal

that would make an exception to that requirement under the circumstances of this case.[28]

3. The Commission's And Respondent's Positions Repeatedly Exalt Form Over Substance

The Commission and Respondent each urge that a finding of standing is required in this case to avoid exalting form over substance. SEC Br. at 26 (Court should disregard merger into subsidiary of acquiring corporation as in "substance . . . identical" to merger into acquiring corporation itself); Resp. Br. at 22-25 (separate corporate entities should be disregarded). It is difficult to imagine a greater emphasis on form, however, than the Commission's contrived approach in which it claims that the statute requires a plaintiff to own securities in the issuer at the instant—but only at the instant—the suit is filed. In addition, the Commission's apparent distinctions among various types of transactions all of which result in a plaintiff ceasing to be a security owner of

acts of defendants; and (3) the remedy sought would result in plaintiffs regaining shareholder status"); *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984) (Delaware law: stock-for-stock merger in which plaintiff becomes shareholder of new parent corporation; neither of two recognized exceptions—where merger itself is based on fraud or where merger is part of reorganization which does not affect plaintiff's ownership of the business enterprise—apply); *Kramer v. Western Pac. Indus., Inc.*, 546 A.2d 348, 354-55 (Del. 1988) (same—narrowly interpreting *Lewis v. Anderson* exceptions); *Zauber v. Murray Savings Ass'n*, 591 S.W.2d 932, 937-38 (Tex. Civ. App. 1979) (Texas law: shareholder cashed out in reverse stock split; shareholder may maintain standing if corporate action taken solely to defeat standing), *applic. for writ of error denied*, 601 S.W.2d 940 (Tex. 1980).

28 The Commission cites two cases, *Gaillard v. Natomas Co.*, 173 Cal. App. 3d 410, 219 Cal. Rptr. 74 (1985), and *Alford v. Shaw*, 327 N.C. 526, 398 S.E.2d 445 (1990), for the proposition that the continuous ownership requirement is not applied where the plaintiff's shares are exchanged for shares of the new corporate parent. SEC Br. at 20 & n.23. However, in each of these cases, the court's decision not only rested on a narrow interpretation of the particular state statutory provision governing derivative actions, *see Gaillard*, 219 Cal. Rptr. at 76-77; *Alford*, 398 S.E.2d at 449, but also emphasized that the lawsuit was itself aimed at challenging the wrongfulness of the very merger that deprived the plaintiffs of their shares, *Gaillard*, 219 Cal. Rptr. at 80; *Alford*, 398 S.E.2d at 450.

the issuer also exalt form over substance, as discussed in Part A.1, *supra*.

It is also significant that the very distinction in "form" that is so heavily criticized by the Commission and Respondent is one that has been built into the Exchange Act itself. When Congress wanted to disregard the corporate form in the securities laws, it knew how to do so. *See* note 17, *supra*.

Respondent's argument that the corporate form should be disregarded here on an "alter ego" theory is equally baseless. There is no evidence in the record that the particular form of the transaction through which Viacom acquired International, in which Petitioners played absolutely no role, was anything other than a bona fide, arm's-length transaction.[29] Indeed, if carried to its logical conclusion, Respondent's argument would sweep away the existing caselaw denying standing to shareholders of parent or grandparent corporations to bring Section 16(b) actions.[30]

Finally, the Commission itself exalts form over substance by engaging in a game of labels—claiming that this Court's well-established jurisprudence under Section 16(b), which has rejected an "expansive" interpretation of the statute—has no application here because this suit involves "standing," while this Court's prior decisions involved "liability." SEC Br. at 22-23. But the enforcement mechanism is an integral part of any statutory scheme, and Section 16(b) is no exception. Moreover, Section 16(b)'s straightforward language stating who may bring an action under it—"the issuer, or . . . the owner of any security of the issuer"—is plainly cut from the same mold as the straightforward language governing liability.

29 The two cases, each well over 50 years old, relied on by Respondent for the proposition that the corporate form may be readily disregarded in the name of "public policy" are inapposite. These cases involved efforts by shareholders of corporations to limit their liability for injuries caused by the corporation. Whatever vitality they may still have beyond their particular facts, they can have no application to the question of who has been authorized by Congress to bring a particular lawsuit—especially under the mechanically applied provisions of Section 16(b).

30 *See* cases cited note 12, *supra*.

B. Respondent May Not Maintain This Section 16(b) Action As A "Double Derivative" Suit

Respondent repeats his assertion, rejected by the District Court below but not addressed by the Court of Appeals—and which the Commission does not address in its brief—that he may properly bring this action as a "double derivative" action. This assertion must plainly be rejected as a subterfuge to evade the explicit standing requirements of Section 16(b). As the District Court noted in rejecting this argument:

> Section 16(b)'s standing requirements are specific, and must be strictly construed. If successful, plaintiff would enlarge the class of persons entitled to sue under § 16(b) to include shareholders of a shareholder. However, shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b).

Mendell v. Gollust, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086, at 91,087 (S.D.N.Y. Nov. 8, 1988); 33a (citation omitted). The District Court was clearly correct: Congress's *express* authorization within Section 16(b) itself of a single derivative action is inconsistent with an *implied* authorization of multiple derivative actions as well. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297, 299 (S.D.N.Y. 1987) ("The validity of multiple derivative suits in other contexts does not justify circumvention of section 16(b)'s specific standing requirements." (citations omitted)), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988).

CONCLUSION

The judgment of the Court of Appeals should be reversed, and the case should be remanded to the Court of Appeals with directions to affirm the order appealed from.

Dated: April 5, 1991

Respectfully submitted,

Edwin B. Mishkin
(Counsel of Record)
Victor I. Lewkow
Thomas G. Dagger
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, New York 10006
(212) 225-2000

Attorneys for Petitioners